73

53078B (5)

193pg

No. 06-1509

Supreme Court, U.S.
FILED
NOV 5 - 2007
OFFICE OF THE CLERK

In The

Supreme Court of the United States

MICHAEL H. BOULWARE,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

JOINT APPENDIX

JOHN D. CLINE
Counsel of Record
KELLI CROUCH
JONES DAY
555 California Street
26th Floor
San Francisco, CA 94104
(415) 626-3939
jcline@jonesday.com
Counsel for Petitioner

PAUL D. CLEMENT
Solicitor General
Counsel of Record
DEPARTMENT OF JUSTICE
Washington, DC 20530-0001
(202) 514-2217
supremectbriefs@usdoj.gov
Counsel for Respondent

Petition For Certiorari Filed May 11, 2007
Certiorari Granted September 25, 2007

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

Page

Relevant Docket Entries in the United States District Court for the District of Hawaii 1

Relevant Docket Entries in the United States Court of Appeals for the Ninth Circuit 8

Second Superseding Indictment (Redacted Version) 9

Memorandum in Support of Motion in Limine to Preclude Defendant From Introducing Evidence, Testimony and Argument Relating to the Issues of Constructive Distribution and Returns of Capital as to Michael H. Boulware 19

Defendant Michael H. Boulware's Proposed Supplemental Jury Instructions 24

United States' Objections to Defendant's Proposed Supplemental Jury Instructions 31

Transcript of Proceedings (June 28, 2005) 41

Transcript of Proceedings (June 29, 2005) 45

Transcript of Proceedings (June 30, 2005) 48

Memorandum in Opposition to Motion in Limine to Preclude Defendant From Introducing Evidence, Testimony and Argument Relating to the Issues of Constructive Dividends and Returns of Capital 57

TABLE OF CONTENTS – Continued

Page

Transcript of Proceedings (July 1, 2005) 67

Defendant Michael H. Boulware's Motion for Leave to Present Evidence of Reporting of Excess Income By HIE, Offer of Proof and Request for FRE Rule 104 Hearing 93

Memorandum in Opposition to Defendant's Motion for Leave to Present Evidence of Reporting of Excess Income By HIE, Offer of Proof and Request for F.R.E. 104 Hearing 103

Transcript of Proceedings (July 11, 2005)..... 115

Transcript of Proceedings (July 12, 2005) 143

Transcript of Proceedings (July 13, 2005) 163

Transcript of Proceedings (July 14, 2005) 172

Judgment in a Criminal Case..... 176

Notice of Appeal 188

TABLE OF CONTENTS – Continued

Page

The following documents have been omitted in the printing of this Joint Appendix. They may be found in the Appendix to the Petition for Writ of Certiorari at the following pages:

Opinion of the United States Court of Appeals for the Ninth Circuit, Decided September 14, 2004 ..... App. 27

Transcript of Proceedings on July 1, 2005 Before the United States District Court for the District of Hawaii ..... App. 15

Transcript of Proceedings on July 11, 2005 Before the United States District Court for the District of Hawaii ..... App. 20

Transcript of Proceedings on July 14, 2005 Before the United States District Court for the District of Hawaii ..... App. 24

Opinion of the United States Court of Appeals for the Ninth Circuit, Decided December 13, 2006 ..... App. 1

Order of the United States Court of Appeals for the Ninth Circuit Denying Petition for Rehearing En Banc, Decided April 23, 2007 ..... App. 63

RELEVANT DOCKET ENTRIES

DISTRICT COURT

Date Filed	#	Docket Text
05/19/1999	1	EP: INDICTMENT by USA Counts filed against Michael H. Boulware (1) count(s) 1-4, 5, 6-9, 10; PS ordered (Maryann Shawler) by Mag Judge YAMASHITA (gab) Modified on 05/19/1999 Additional attachment(s) added on 6/13/2006 (bbb,). (Entered: 05/19/1999)
02/14/2001	167	EP: SUPERSEDING INDICTMENT by USA; naming Michael H. Boulware counts filed against Michael H. Boulware (1) count(s) 1ss-6ss, 7ss, 8ss, 9ss, 10ss, 11ss, 12ss, 13ss, 14ss, 15ss-18ss, 19ss ordered (Bruce Gettman) by Mag Judge CHANG (gab) Additional attachment(s) added on 6/13/2006 (bbb,). (Entered: 02/15/2001)
11/29/2001	302	EP: MINUTES: Further Jury Deliberation (4th Day) – 12 Jurors present. Court read the Verdict in open Court – Defendant Present not in Custody and Also present the 12 Jurors. Defendant was found Guilty as to Cts 1, 2, 3, 4, 5, 6, 7, 8, 9 & 10 and Not Guilty as to Cts 11, 12, 13 & 14. Jurors were polled. . . . (Ct Rptr: Stephen Platt) by Judge Rafeedie (gs) (Entered: 12/04/2001)

05/06/2002	352	EP: MINUTES: Sentence as to Counts 1 through 10 and Various Motions – Deft present not in custody; Deft's Motion for New Trial – DENIED; Deft's Motion for Judgment of Acquittal – DENIED; Govt's Entry of forfeiture (as to Count 19 of the Second Superseding Indictment) – (money judgment) – GRANTED; The Court adopts the factual findings and guideline application in the presentence report except as to certain facts and issues that were stated for the record and reflected on the Statement of Reasons; Deft request for Downward Departure – Granted in Part and Denied in part; Deft addresses the Court; Sentence as to Counts 1 through 10 – [346-1], [336-1], [310-1], [307-1] Imprisonment – 36 Months as to each of Counts 1 to 5, 51 Months as to each of Counts 6 to 9 and 51 Months to Count 10 such terms to run concurrently with each other Supervised Release – 1 Year as to each of Counts 1 to 5 and 3 years as to each of Counts 6 to 10 all terms to run concurrently. . . . (Ct Rptr: Cynthia Fazio) by Judge Rafeedie (gs) (Entered: 05/17/2002)
01/21/2005	381	APPEAL Judgment from 9CCA reversing and remanding the Decision of the District Court

		[Appeal [353-1] filed and entered: 9/14/2004 Attest date: 1/14/2005 (cc: all counsel, USPO, USM, Judge, Mag Judge, CRD) as to CA 02-10287; reverse Boulware's conviction for tax evasion and filing false tax returns and affirm his conviction for conspiracy to make false statements to a federally insured financial instutution; vacate his sentence on the false statement count and remand for further proceedings consistent with this opinion (eps) Additional attachment(s) added on 7/25/2006 (bbb). Entered: 01/25/2005)
06/20/2005	407	Proposed SUPPLEMENTAL jury instructions (redacted set); certificate of service – by defendant Michael H. Boulware [406-1] (lmg) (Entered: 06/21/2005)
06/23/2005	414	United States' OBJECTIONS to Defendant's proposed supplemental jury instructions [407-1]; certificate of service (bbb) (Entered: 06/27/2005)
06/30/2005	425	United States MOTION in limine to Preclude Defendant From Introducing evidence, testimony and argument relating to the issues of constructive distributions and returns of capital as to Michael H. Boulware (gs) (Entered: 06/30/2005)

06/30/2005	427	MEMORANDUM in support of motion in limine to Preclude Defendant From Introducing evidence, testimony and argument relating to the issues of constructive distributions and returns of capital as to Michael H. Boulware [425-1] by plaintiff USA (gs) (Entered: 06/30/2005)
07/01/2005	428	MEMORANDUM in opposition to motion in limine to Preclude Defendant From Introducing evidence, testimony and argument relating to the issues of constructive distributions and returns of capital filed on June 30, 2005; certificate of service [425-1] by defendant Michael H. Boulware (eps) (Entered: 07/05/2005)
07/05/2005	433	Notice of Motion and MOTION for leave to present evidence of reporting of excess income by HIE, offer of proof and request for FRE Rule 104 hearing by defendant Michael H. Boulware – referred to Judge Edward Rafeedie (lmg) (Entered: 07/06/2005)
07/01/2005	446	EP: MINUTES: Further Jury Trial Date-(5th Day)-Defendant present not in Custody. Also present 12 Jurors and 2 Alternate Jurors. Defendant Witnesses-Sidney Boulware-CST, James

Chan-Previously Sworn in, Michael McCarthy-Previously Sworn in and Stanley Wachi-CST. Defendant's Exhibits-1000, 1001, 1002, 1003, 1005, 1006, 1007, 1008 and 1682-Admitted. Deft's Motion for leave to present evidence of reporting of excess income by HIE, offer of proof and request for FRE Rule 104 Hearing-is hereby Denied [438-1]. Government's Motion in Limine to preclude Defendant from introducing evidence testimony and argument relating to the issues of constructive distributions and returns of capital-is hereby Granted [425-1].

07/06/2005	439	MEMORANDUM in opposition to defendant's motion for leave to present evidence of reporting of excess income by HIE, offer of proof and request for F.R.E. 104 hearing; certificate of service [438-1] – by plaintiff (lmg) (Entered: 07/06/2005)
07/15/2005	456	EP: MINUTES: Further Jury Deliberations (2nd Day) – 12 Jurors present. Return of the Verdict-Defendant present not in Custody and 12 Jurors are also present. As to Count 1, 2, 3, 4, 5,6, 7, 8 and 9 – Guilty as to each of these counts. Jurors were

polled. . . . (Ct Rptr: Stephen Platt) by Judge Edward Rafeedie (eps) (Entered: 07/25/2005)

10/24/2005 477 EP: MINUTES: Sentence as to Counts 1 2, 3, 4, 5, 6, 7, 8, 9 and 10 of the Second Superseding Indictment, Defendant's Request for Downward Departure and Defendant's Motion for Release pending Appeal – Defendant present not in Custody. The Court adopts the presentence report and guideline applications but with some changes. Defendant's Request for Downward Departure – Granted in Part and Denied in Part.

Defendant addresses the Court. sentencing Michael H. Boulware (1) count(s) 1 ss-5ss, 7ss, 9ss, 10ss. Sentence as to Counts 1, 2, 3, 4, 5, 6, 7, 8, 9 and 10 of the Second Superseding – Imprisonment – 36 Months as to each of Counts 1 through 5, such terms to run concurrently with each other. 60 Months as to each of Counts 6 through 10, such terms to run concurrently with each other, all terms to run Court will allow the Defendant to self surrender to the prison facility designated by the Bureau of Prison. Stayed to January 05, 2006 by 2:00 p.m. Local Time. . . . (Ct Rptr: ESR/B Biacan)

		by Judge Edward Rafeedie (eps) (Entered: 10/27/2005)
10/27/2005	482	JUDGMENT and Commitment as to Michael Boulware by Judge Edward Rafeedie (cc: all counsel) (ecs) Additional attachment(s) added on 8/4/2006 (tbf,). Entered: 11/04/2005)
11/02/2005	483	NOTICE OF APPEAL by defendant Michael H. Boulware regarding [482-1] fees paid (receipt #232428) (ecs) (Entered: 11/15/2005)

U.S. COURT OF APPEALS - 9TH CIRCUIT

05-10752 USA v. Boulware

12/13/06	FILED OPINION: AFFIRMED (Terminated on the Merits after Oral Hearing; Affirmed; Written, Signed, Published. Pamela A. RYMER, author; Sidney R. THOMAS, concurring; Stephen G. Larson.) FILED AND ENTERED JUDGMENT. [05-10752] (ba) [05-10752]
4/23/07	Filed order (Pamela A. RYMER, Sidney R. THOMAS, Stephen G. Larson,): The petition for rehearing and the petition for rehearing en banc are DENIED. [6043476-1] [05-10752] (ba) [05-10752]
5/1/07	MANDATE ISSUED [05-10752] (ba) [05-10752]

STEVEN S. ALM
United States Attorney
District of Hawaii

ELLIOT ENOKI
First Assistant U.S. Attorney

LESLIE E. OSBORNE, JR.
J. MICHAEL SEABRIGHT
RACHEL S. MORIYAMA
Assistant U.S. Attorneys
Room 6-100, PJKK Federal Building
300 Ala Moana Blvd., Box 50183
Honolulu, Hawaii 96850
Telephone: (808) 541-2850

EDWARD E. GROVES
Special Attorney
U.S. Department of Justice, Tax Division
950 Pennsylvania Avenue, NW, Room 4132
Washington, D.C. 20530
Telephone: (202) 514-5193

Attorneys for Plaintiff
UNITED STATES OF AMERICA

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA Plaintiff, v. MICHAEL H. BOULWARE, Defendant.	CR. NO. 99-00239 DAE SECOND SUPERSEDING INDICTMENT [26 U.S.C. §§ 7206(1) and 7201; 18 U.S.C. §§ 371, 1014, and 982]

SECOND SUPERSEDING INDICTMENT

(Filed Feb. 14, 2001)

COUNT 1

The Grand Jury charges:

On or about June 8, 1993, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully make and subscribe a Form 1040 U.S. Individual Income Tax Return for the calendar year 1989, which was filed over three years late with the Internal Revenue Service and was false as to a material matter and verified by a written declaration that it was made under the penalties of perjury, which said income tax return he did not believe to be true and correct as to every material matter in that his income tax return reported total income of $207,522.00, whereas defendant MICHAEL H. BOULWARE then and there well new and believed that his total income was substantially in excess of that reported amount as his income

tax return omitted additional total income of approximately $1,072,000.00.

All in violation of Title 26, United States Code, Section 7206(1).

COUNT 2

The Grand Jury further charges:

On or about June 8, 1993, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully make and subscribe a Form 1040 U.S. Individual Income Tax Return for the calendar year 1990, which was filed over two years late with the Internal Revenue Service and was false as to a material matter and verified by a written declaration that it was made under the penalties of perjury, which said income tax return he did not believe to be true and correct as to every material matter in that his income tax return reported total income of $513,495.00, whereas defendant MICHAEL H. BOULWARE then and there well knew and believed that his total income was substantially in excess of that reported amount as his income tax return omitted additional total income of approximately $917,000.00.

All in violation of Title 26, United States Code, Section 7206(1).

COUNT 3

The Grand Jury further charges:

On or about June 8, 1993, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully make and subscribe a Form 1040 U.S. Individual Income Tax Return for the calendar year 1991, which was filed late with the Internal Revenue Service and was false as to a material matter and verified by a written declaration that it was made under the penalties of perjury and which said income tax return he did not believe to be true and correct as to every material matter in that his income tax return reported total income of $684,808.00, whereas defendant MICHAEL H. BOULWARE then and there well knew and believed that his total income was substantially in excess of that reported amount as his income tax return omitted additional total income of approximately $1,927,000.00.

All in violation of Title 26, United States Code, Section 7206(1).

COUNT 4

The Grand Jury further charges:

On or about June 8, 1993, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully make and subscribe a Form 1040 U.S. Individual Income Tax Return for the calendar year 1992, which was filed

late with the Internal Revenue Service, was false as to a material matter and verified by a written declaration that it was made under the penalties of perjury and which said income tax return he did not believe to be true and correct as to every material matter in that his income tax return reported total income of $739,225.00, whereas defendant MICHAEL H. BOULWARE then and there well knew and believed that his total income was substantially in excess of that reported amount as his income tax return omitted additional total income of approximately $1,556,000.00.

All in violation of Title 26, United States Code, Section 7206(1).

COUNT 5

The Grand Jury further charges:

On or about August 15, 1994, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully make and subscribe a Form 1040 U.S. Individual Income Tax Return for the calendar year 1993, which was filed with the Internal Revenue Service and was false as to a material matter and verified by a written declaration that it was made under the penalties of perjury, which said income tax return he did not believe to be true and correct as to every material matter in that his income tax return reported total income of $1,443,990.00, whereas defendant MICHAEL H. BOULWARE then and there well knew and believed

that his total income was substantially in excess of that reported amount as his income tax return omitted additional total income of approximately $1,092,000.00.

All in violation of Title 26, United States Code, Section 7206(1).

COUNT 6

The Grand Jury further charges:

On or about October 15, 1995, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully attempt to evade and defeat a large part of the income tax due and owing by him to the United States of America for the calendar year 1994, by signing and causing to be signed, a false and fraudulent Form 1040 U.S. Individual Income Tax Return, filed with the Internal Revenue Service, by diverting money from Hawaiian Isles Enterprises, Inc. to himself through the use of Automated Equipment, Ltd., a Hawaii corporation wholly owned by defendant MICHAEL H. BOULWARE, for the purpose of concealing additional unreported taxable income received by defendant MICHAEL H. BOULWARE during the calendar year 1994, for which his reported taxable income was the sum of $960,199.00, whereas, he then and there well knew and believed his unreported taxable income for that year was approximately $1,312,595.00, on which said taxable income there was due and owing to the

United States of America an income tax of $519,788.00.

All in violation of Title 26, United States Code, Section 7201.

COUNT 7

The Grand Jury further charges:

On or about September 30, 1996, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully attempt to evade and defeat a large part of the income tax due and owing by him to the United States of America for the calendar year 1995, by signing and causing to be signed, a false and fraudulent Form 1040 U.S. Individual Income Tax Return, which was filed with the Internal Revenue Service, by diverting money from Hawaiian Isles Enterprises, Inc. to himself through the use of Automated Equipment, Ltd., a Hawaii corporation wholly owned by defendant MICHAEL H. BOULWARE, and by diverting money from Hawaiian Isles Enterprises, Inc. to himself through the use of off-shore bank accounts located in Hong Kong and the Kingdom of Tonga, for the, purpose of concealing additional unreported taxable income received by defendant MICHAEL H. BOULWARE during the calendar year 1995, for which his reported taxable income was the sum of $317,858.00, whereas, he then and there well knew and believed his unreported taxable income for that year was approximately $1,095,258.00, on which said taxable income there

was due and owing to the United States of America an income tax of $433,722.00.

All in violation of Title 26, United States Code, Section 7201.

COUNT 8

The Grand Jury further charges:

On or about August 7, 1997, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully attempt to evade and defeat a large part of the income tax due and owing by him to the United States of America for the calendar year 1996, by signing and causing to be signed, a false and fraudulent Form 1040 U.S. Individual Income Tax Return, which was filed with the Internal Revenue Service, by diverting money from Hawaiian Isles Enterprises, Inc. to himself through the use of off-shore bank accounts located in Hong Kong and the Kingdom of Tonga, for the purpose of concealing additional unreported taxable income received by defendant MICHAEL H. BOULWARE during the calendar year 1996, for which his reported taxable income was the sum of $833,709.00, whereas, he then and there well knew and believed his unreported taxable income for that year was approximately $898,293.00, on which said taxable income there was due and owing to the United States of America an income tax of $355,724.00.

All in violation of Title 26, United States Code, Section 7201.

COUNT 9

The Grand Jury further charges:

On or about October 14, 1998, in the District of Hawaii, defendant MICHAEL H. BOULWARE, a resident of Honolulu, Hawaii, did willfully attempt to evade and defeat a large part of the income tax due and owing by him to the United States of America for the calendar year 1997, by signing and causing to be signed, a false and fraudulent Form 1040 U.S. Individual Income Tax Return, which was filed with the Internal Revenue Service, by diverting money from Hawaiian Isles Enterprises, Inc. to himself through the use of off-shore bank accounts located in Hong Kong, for the purpose of concealing additional unreported taxable income received by defendant MICHAEL H. BOULWARE during the calendar year 1997, for which his reported taxable income was the sum of $1,173,617.00, whereas, he then and there well knew and believed his unreported taxable income for that year was approximately $73,243.00, on which said taxable income there was due and owing to the United States of America an income tax of $29,004.00.

All in violation of Title 26, United States Code, Section 7201.

DATED: February 14, 2001, at Honolulu, Hawaii.

A TRUE BILL

/s/ [Illegible]
FOREPERSON, GRAND JURY

/s/ Steven S. Alm
STEVEN S. ALM
United States Attorney
District of Hawaii

/s/ [Illegible]
ELLIOT ENOKI
First Assistant U.S. Attorney

/s/ J. Michael Seabright
LESLIE E. OSBORNE
J. MICHAEL SEABRIGHT
RACHEL S. MORIYAMA
Assistant U.S. Attorneys

/s/ Edward E. Groves
EDWARD E. GROVES
Special Attorney
U.S. Department of Justice, Tax Division

USA v. MICHAEL H. BOULWARE
Cr. No. 99-00239 DAE; "Second Superseding Indictment"

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, v. MICHAEL H. BOULWARE, Defendant.	CR. NO. 99-00239 ER MEMORANDUM IN SUPPORT OF MOTION *IN LIMINE* TO PRECLUDE DEFENDANT FROM INTRODUCING EVIDENCE, TESTIMONY AND ARGUMENT RELATING TO THE ISSUES OF CONSTRUCTIVE DIVIDENDS AND RETURNS OF CAPITAL

MEMORANDUM IN SUPPORT OF MOTION *IN LIMINE* TO PRECLUDE DEFENDANT FROM INTRODUCING EVIDENCE, TESTIMONY AND ARGUMENT RELATING TO THE ISSUES OF CONSTRUCTIVE DIVIDENDS AND RETURNS OF CAPITAL

(Filed Jun. 30, 2005)

The United States of America, by and through the undersigned attorney, files this memorandum in support of its Motion *In Limine* to Preclude Defendant from Introducing Evidence, Testimony and Argument Relating to the Issue of Constructive Dividends and Returns of Capital.

Based on the evidence and testimony offered thus far, it appears that the defendant intends to offer evidence, testimony and argument relating to the issue of constructive dividends and returns of capital. Such evidence, testimony and argument should be precluded because it is irrelevant in a criminal tax prosecution.

In *United States v. Miller*, 545 F. 2d 1204 (9th Cir. 1976), the Ninth Circuit held that the civil tax rules relating to the complex issues of constructive dividends and returns of capital do not automatically apply in criminal tax evasion prosecutions. *United States v. Miller*, 545 F. 2d 1204, 1214 (9th Cir. 1976). In *Miller*, the defendant was tried and convicted of tax evasion. On appeal, the defendant challenged the conviction contending that the money he had diverted to himself was not income. More specifically, the defendant maintained that the diverted moneys should be treated as constructive dividends and analyzed in accordance with the relevant Internal Revenue Code sections that govern such distributions. *United States v. Miller*, 545 F. 2d 1204, 1211-12 (9th Cir. 1976). Under those relevant sections, the defendant claimed, it can only be considered a dividend, and thus income to him, if the company had corporate earnings. *Id.* Because the corporation did not have earnings during the prosecution years, the defendant maintained that the diverted funds should be considered returns of capital and thus nontaxable. *United States v. Miller*, 545 F. 2d 1204, 1211-12 (9th Cir. 1976).

The Ninth Circuit rejected the defendant's contention noting that the issue in a tax fraud case is "not over the specific amount of tax that the defendant has evaded, but whether he has willfully attempted to evade the payment or assessment of a tax." *United States v. Miller*, 545 F. 2d 1204, 1214 (9th Cir. 1976). Thus, the defendant's claim that the constructive distribution rules should automatically apply would "nullify all of the taxpayer's prior unlawful acts." *Id.* "To hold otherwise would be to permit the taxpayer to divert such funds and if not caught, to later pay out another return of capital; or, if caught, to avoid conviction by raising the defense that the sums were a return of capital." *United States v. Miller,* 545 F. 2d 1204, 1215 (9th Cir. 1976).

Of course, that is not to say that a defendant can never claim that diverted funds were returns of capital. *United States v. Miller*, 545 F. 2d 1204, 1214 (9th Cir. 1976). However, before the defendant can take advantage of any such claim, he must lay the necessary foundation for their application. *Id.* More specifically, before the constructive distribution rules apply, "there must be some demonstration on the part of the taxpayer and/or the corporation that such

distributions were intended to be [a return of capital]" *United States v. Miller*, 545 F.2d 1204, 1214 (9th Cir. 1976),

Where, however, no such foundation is laid, the constructive distribution rules are irrelevant to the issues in criminal tax prosecutions and do not apply. *United States in Miller*, 545 F. 2d 1204, 1215 (9th Cir. 1976). The Ninth Circuit recently affirmed the holding in *Miller*, in the defendant's appeal of his first trial. *United States in Boulware*, 384 F.3d 794, 810 (9th Cir. 2004). Specifically, the *Boulware* court held that the government can satisfy its burden on both tax evasion and false returns "without proving either that Boulware stole the funds from HIE or that the funds were not loans or *nontaxable returns of capital.*" *United States v. Boulware*, 384 F.3d 794, 810 (9th Cir. 2004).[1]

In the instant matter, it appears that the defendant may contend that some of the diverted funds should be considered constructive distributions or returns of capital. However, there has been no foundation laid for the consideration of such a claim. Indeed, the company controller, Merwyn Manago,

---

[1] To the extent that the defendant intends to claim that the government must prove theft or disprove a loan theory in order to prove the defendant guilty of tax evasion and false returns, the government moves to exclude any such line of inquiry or contentions. The Ninth Circuit specifically rejected such a claim in the defendant's appeal of his first trial. *United States v. Boulware*, 384 F.3d 794, 810 (9th Cir. 2004).

testified that during the prosecution years there were no returns of capital. The defendant has offered no evidence to indicate otherwise. Accordingly, absent such foundation, any evidence, testimony and argument relating to the issues of constructive distributions and returns of capital should be excluded.

DATED: June 29, 2005 at Honolulu, Hawaii

Respectfully submitted,

EDWARD H. KUBO
United States Attorney
District of Hawaii

By /s/ Leslie E. Osborne
LESLIE E. OSBORNE
Assistant United States Attorney
JARED E. DWYER
Trial Attorney
U.S. Department of Justice
Tax Division

Attorneys for Plaintiff
UNITED STATES OF AMERICA

REINWALD O'CONNOR & PLAYDON LLP
A Limited Liability Law Partnership

DENNIS E. W. O'CONNOR 561-0
24th Floor, Makai Tower
Pacific Guardian Center
733 Bishop Street
Honolulu, Hawaii 96813
Telephone: (808) 524-8350

Attorney for Defendant
MICHAEL H. BOULWARE

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CR NO. 99-00239 ER DEFENDANT MICHAEL H. BOULWARE'S PROPOSED SUPPLEMENTAL JURY INSTRUCTIONS; CERTIFICATE OF SERVICE TRIAL DATE: JUNE 27, 2005 TIME: 9:00 A.M. JUDGE: HON. EDWARD RAFEEDIE

DEFENDANT MICHAEL H. BOULWARE'S PROPOSED SUPPLEMENTAL JURY INSTRUCTIONS

(Filed Jun. 20, 2005)

Defendant MICHAEL H. BOULWARE ("BOULWARE"), by and through his attorneys, Reinwald O'Connor and Playdon LLP, pursuant to the Court's order of May 24, 2005, the attached proposed substantive jury instructions.

DATED: Honolulu, Hawaii, June 20, 2005.

/s/ [Illegible]
DENNIS E.W. O'CONNOR
Attorney for Defendant
MICHAEL H. BOULWARE

* * *

DEFENDANT'S PROPOSED
JURY INSTRUCTION NO. 4

The term "taxable income" in federal income law includes the net proceeds (meaning proceeds reduced by allowable deductions) realized from wages, salaries, compensation from professions, vocations, trades, businesses, commerce, rents, royalties, sales or dealings in real or personal properties, interest, dividends, and, in general, immediately enjoyable economic benefits derived from any source whatsoever, in any given taxable year. It does not matter that the income is derived by illegal means as long as the taxpayer does not take possession of property with mutual understanding and acknowledgment with the victim that another is its rightful owner.

Not all money or property that may come into possession of a taxpayer or applied to his use or benefit during a taxable year is taxable income, known as "nontaxable receipts". The proceeds from

loans or funds delivered by a corporation to an employee to be utilized for corporate purposes, called "advances", gifts and inheritances, or money or property that represents the return of funds invested or repayment of loans, or, advances previously made are examples of nontaxable receipts realized by a taxpayer.

A loan occurs when monies are delivered by a person called "lender" to another called a "borrower", pursuant to a verbal or written understanding held by each of the parties that the borrower is required to return the entire sum to the lender at a future time. An advance occurs when funds are delivered by one person "bailor" to another, "bailee", with a verbal or written understanding held by each of them that the funds belong at all times to the bailor and are to be held and utilized by the bailee for the bailor's specified purpose and benefit. If you find that the funds delivered to the Defendant were either loans or advances, you are instructed that the amounts are not taxable income and therefore the Defendant had no duty to report any of such loans or advances as taxable income on his tax returns.

On the other hand, if you find that the monies were not loans or advances and were utilized for the personal benefit of the Defendant, with no intention by the Defendant to repay HIE, then the amounts so expended in each of the respective taxable years are corporate dividends constructively paid to him by HIE but limited to the payments less the returns by the Defendant to HIE during or prior to each of the

taxable years under review. The law provides that dividends are taxable income to a shareholder only if HIE had "earnings and profits", a term which is akin to accumulated corporate profits, first for the taxable year under review, and then from all prior years. Therefore, any dividend distributions in excess of earnings and profits are deemed nontaxable return of the shareholder's investment in his corporate shares, while the balance of the distributions, if any, are taxable income. It is the taxpayer's contention that HIE had no earnings and profits during each of the years under indictment and, furthermore, that the entire amount of distribution did not exceed his investment in the shares of HIE, thereby rendering the entire amount distributed as nontaxable. Accordingly, the Defendant contends that he had no duty to report any of the amounts in question as taxable income on his tax returns.

An important question in this case is whether funds delivered to the Defendant by Hawaiian Isles Enterprises, Inc. ("HIE") and applied for the personal benefit of the Defendant in the annual amounts charged in the indictments were nontaxable receipts such as loans or advances from HIE; or, whether the funds were obtained by the Defendant to principally benefit him and, with the intention never to repay or return the monies to HIE, in which case the funds are taxable to the Defendant as constructive dividends, irrespective of the fact that the transactions are described as loans or advances.

The Government has the burden of proof in establishing every fact that is material and necessary to prove by competent evidence beyond a reasonable doubt that the Defendant realized taxable income and therefore had a duty to report on each of the tax returns in question the respective amounts of additional taxable income asserted in the indictment, but willfully failed to do so. This burden does not at any time or under any circumstance shift from the Government. It is not sufficient for the Government to prove any material fact by suspicion, innuendo, conjecture or by aspersions cast upon the accused by the prosecution. It is not sufficient to establish the existence of unreported taxable income if the evidence presented is evenly divided between taxable and nontaxable income.

U.S. v. Beck, 59-2 USTC (CCH) p9486, *rev'd in part, aff'd in part,* 298 F.2d 622 (9th Cir. 1962); *U.S. v. D'Agostino,* 145 F.3d 69 (2nd Cir. 1998); 26 U.S.C. § 201(c); Action on Decision, CC 1988-025 (Sept. 12, 1988).

GIVEN _____

REFUSED _____

MODIFIED _____

DEFENDANT'S PROPOSED
JURY INSTRUCTION NO.5

Evidence has been introduced to establish that the defendant was a stockholder in Hawaiian Isles

Enterprises, Inc., a corporation, and obtained money from the corporation which the Government contends should have been reported on the defendant's personal tax return.

The defendant has introduced evidence to establish that the money obtained by the defendant from HIE was not income to the defendant but a loan from the corporation or a nontaxable return of the defendant's investment in the corporation or a corporate dividend which was nontaxable because the corporation had no earnings and profits for the years in question.

In determining whether the defendant received any income from his corporation, you are instructed as follows:

1. Dividend. A distribution by a corporation to or for the benefit of a stockholder that is not a loan is reportable as a dividend to the extent that the distribution (or any part thereof) could have been paid out of the accumulated earnings and profits of the corporation; or out of the earnings and profits of the corporation for the taxable year in issue.

2. Return of Capital. If the accumulated and current earnings and profits of the corporation are not great enough in amount to account for all, or a part of, the distribution to the defendant, then that portion of the distribution which could not be paid out of earnings and profits would be a nontaxable return of capital up to the amount of money invested in the corporation by the defendant.

3. Capital Gain Income. Finally, any portion of the distribution which exceeds both the accumulated earnings and profits of the corporation and the amount the defendant had invested in the corporation, would be capital gain income to the defendant.

4. Loan. If you find that a distribution received by the defendant (or any part thereof) was a loan from the corporation, which was repaid or to be repaid, then to the extent that the distribution was a loan, it would not be income to the defendant.

Department of Justice Criminal Tax Manual Model Jury Instructions No. 302.

GIVEN _____

REFUSED _____

MODIFIED _____

* * *

EDWARD H. KUBO, JR. #2499
United States Attorney
District of Hawaii

LESLIE E. OSBORNE, JR.
Assistant U.S. Attorney
Room 6-100, PJKK Federal Building
300 Ala Moana Boulevard
Honolulu, Hawaii 96850
Telephone: (808) 541-2850

JARED E. DWYER
Trial Attorney
U.S. Department of Justice, Tax Division
P.O. Box 972
Washington, D.C. 20044
Telephone: (202) 514-5189

Attorneys for Plaintiff
UNITED STATES OF AMERICA

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CR. NO. 99-00239 ER UNITED STATES' OBJECTIONS TO DEFENDANT'S PROPOSED SUPPLEMENTAL JURY INSTRUCTIONS; CERTIFICATE OF SERVICE Trial Date: June 27, 2005 Time: 9:00 a.m. Judge: Hon. Edward Rafeedie

UNITED STATES' OBJECTIONS TO DEFENDANT'S PROPOSED SUPPLEMENTAL JURY INSTRUCTIONS

(Filed Jun. 23, 2005)

COMES NOW, the United States of America, by and through its undersigned attorneys, and submits its objections to defendant's proposed supplemental jury instructions dated June 20, 2005. As directed by this Honorable Court, all objections are set forth within; and the proposed instruction is set forth

* * *

(1976). Accordingly, the defendant's proposed instruction confuses the issue.

UNITED STATES ALTERNATIVE JURY INSTRUCTION:

Willfulness as used in these instructions requires the government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.

DEFENDANT'S PROPOSED SUPPLEMENTAL JURY INSTRUCTION NO. 4

The term "taxable income" in federal income tax law includes the net proceeds (meaning proceeds reduced by allowable deductions) realized from wages, salaries, compensation from professions, vocations, trades, businesses, commerce, rents, royalties, sales or

dealings in real or personal properties, interest, dividends, and, in general, immediately enjoyable economic benefits derived from any source whatsoever, in any given taxable year. It does not matter that the income is derived by illegal means as long as the taxpayer does not take possession of property with mutual understanding and acknowledgment with the victim that another is its rightful owner.

Not all money or property that may come into possession of a taxpayer or applied to his use or benefit during a taxable year is taxable income, known as "nontaxable receipts". The proceeds from loans or funds delivered by a corporation to an employee to be utilized for corporate purposes, called "advances", gifts and inheritances, or money or property that represents the return of funds invested or repayment of loans, or, advances previously made are examples of nontaxable receipts realized by a taxpayer.

A loan occurs when monies are delivered by a person called "lender" to another called a "borrower", pursuant to a verbal or written understanding held by each of the parties that the borrower is required to return the entire sum to the lender at a future time. An advance occurs when funds are delivered by one person "bailor" to another, "bailee", with a verbal or written understanding held by each of them that the funds belong at all times to the bailor and are to be held and utilized by the bailee for the bailor's specified purpose and benefit. If you find that the funds delivered to the Defendant were either loans or

advances, you are instructed that the amounts are not taxable income and therefore the Defendant had no duty to report any of such loans or advances as taxable income on his tax returns.

On the other hand, if you find that the monies were not loans or advances and were utilized for the personal benefit of the Defendant, with no intention by the Defendant to repay HIE, then the amounts so expended in each of the respective taxable years are corporate dividends constructively paid to him by HIE but limited to the payments less the returns by the Defendant to HIE during or prior to each of the taxable years under review. The law provides that dividends are taxable income to a shareholder only if HIE had "earnings and profits", a term which is akin to accumulated corporate profits; first for the taxable year under review, and then from all prior years. Therefore, any dividend distributions in excess of earnings and profits are deemed nontaxable return of the shareholder's investment in his corporate shares, while the balance of the distributions, if any, are taxable income. It is the taxpayer's contention that HIE had no earnings and profits during each of the years under indictment and, furthermore, that the entire amount of distribution did not exceed his investment in the shares of HIE, thereby rendering the entire amount distributed as nontaxable. Accordingly, the Defendant contends that he had no duty to report any of the amounts in question as taxable income on his tax returns.

An important question in this case is whether funds delivered to the Defendant by Hawaiian Isles Enterprises, Inc. ("HIE") and applied for the personal benefit of the Defendant in the annual amounts charged in the indictments were nontaxable receipts such as loans or advances from HIE; or, whether the funds were obtained by the Defendant to principally benefit him and, with the intention never to repay or return the monies to HIE, in which case the funds are taxable to the Defendant as constructive dividends, irrespective of the fact that the transactions are described as loans or advances.

The Government has the burden of proof in establishing every fact that is material and necessary to prove by competent evidence beyond a reasonable doubt that the Defendant realized taxable income and therefore had a duty to report on each of the tax returns in question the respective amounts of additional taxable income asserted in the indictment, but willfully failed to do so. This burden does not at any time or under any circumstance shift from the Government.

It is not sufficient for the Government to prove any material fact by suspicion, innuendo, conjecture or by aspersions cast upon the accused by the prosecution. It is not sufficient to establish the existence of unreported taxable income if the evidence presented is evenly divided between taxable and nontaxable income.

UNITED STATES'
OBJECTION TO INSTRUCTION NO. 2:

The defendant's definition of income is too long and complex and, at this time, unsupported by the evidence. For example, with regard to the portion of the instruction indicating that neither a gift or inheritance is income, there is no evidence whatsoever indicating that any of the charged income could be a gift or an inheritance.

Additionally, with regard to the issue of constructive dividends, the Ninth Circuit requires that "there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be [a return of capital]" *United States v. Miller,* 545 F.2d 1204, 1214-15 (9th Cir. 1976), before a constructive dividend instruction should be given. In this case, there is no indication that there was either a dividend or a return of capitol.

Further, to the extent that a loan instruction is warranted, it should be given, as proposed by the government, in a separate instruction with the applicable law for determining whether there is indeed a loan in existence.

UNITED STATES
ALTERNATIVE JURY INSTRUCTION:

The term gross income for income tax purposes consists of income from whatever source derived, including but not limited to compensation for services.

The term taxable income means gross income minus any deductions allowed by law.

When monies are acquired, lawfully or unlawfully, without consensual recognition of an obligation to repay or restriction on their disposition, such monies are income even though it may still be claimed that the defendant is not entitled to retain the money and even though he may be required to restore its equivalent.

A true loan is not income. *James v. United States,* 366 U.S. 213, 219-20. A true loan is an agreement, either express or implied, whereby one party advances money to the other and the other agrees to repay it upon such terms as to time and rate of interest, or without interest, as the parties may agree. *Welch v. Commissioner of Internal Revenue Service,* 204 F.3d 1228, 1230 (9th Cir. 2000). Alternatively, an alleged loan unaccompanied by a contemporaneous intent to repay, is income in the year in which it was received. *James v. United States,* 366 U.S. 213, 219.

In determining whether a true loan exists, although not exclusive, the following factors are relevant: (1) whether the promise to repay is evidenced by a note or other instrument; (2) whether interest was charged; (3) whether a fixed schedule of repayments was established; (4) whether collateral was given to secure payment; (5) whether repayments were made; (6) whether the borrower had a reasonable prospect of repaying the loan and whether the lender had sufficient funds to advance the loan; and

(7) whether the parties conducted themselves as if the transaction were a loan. *Welch v. Commissioner of Internal Revenue Service,* 204 F.3d 1228, 1230 (9th Cir. 2000).

DEFENDANT'S PROPOSED
SUPPLEMENTAL JURY INSTRUCTION NO. 5

Evidence has been introduced to establish that the defendant was a stockholder in Hawaiian Isles Enterprises, Inc., a corporation, and obtained money from the corporation which the Government contends should have been reported on the defendant's personal tax return.

The defendant has introduced evidence to establish that the money obtained by the defendant from HIE was not income to the defendant but a loan from the corporation or a nontaxable return of the defendant's investment in the corporation or a corporate dividend which was nontaxable because the corporation had no earnings and profits for the years in question.

In determining whether the defendant received any income from his corporation, you are instructed as follows:

1. Dividend. A distribution by a corporation to or for the benefit of a stockholder that is not a loan is reportable as a dividend to the extent that the distribution (or any part thereof) could have been paid out

of the accumulated earnings and profits of the corporation; or out of the earnings and profits of the corporation for the taxable year in issue.

2. Return of Capital. If the accumulated and current earnings and profits of the corporation are not great enough in amount to account for all, or a part of, the distribution to the defendant, then that portion of the distribution which could not be paid out of earnings and profits would be a nontaxable return of capital up to the amount of money invested in the corporation by the defendant.

3. Capital Gain Income. Finally, any portion of the distribution which exceeds both the accumulated earnings and profits of the corporation and the amount the defendant had invested in the corporation, would be capital gain income to the defendant.

4. Loan. If you find that a distribution received by the defendant (or any part thereof) was a loan from the corporation, which was repaid or to be repaid, then to the extent that the distribution was a loan, it would not be income to the defendant.

UNITED STATES'
OBJECTION TO INSTRUCTION NO. 5:

As stated previously, with regard to the issue of constructive dividends, the Ninth Circuit requires that "there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be [a return of capital]" *United*

States v. Miller, 545 F.2d 1204, 1214-15 (9th Cir. 1976), before a constructive dividend instruction should be given. The rational behind such a rule is straightforward: Tax evaders should not escape criminal liability simply because the intricacies of the tax law result in no tax due and owing. *United States v. Miller,* 545 F.2d 1204, 1214-15 (9th Cir. 1976). In this case, there is no indication that there was either a dividend or a return of capitol. Accordingly, there should be no instruction with regard to constructive dividends.

UNITED STATES
ALTERNATIVE JURY INSTRUCTION:

The government has no alternative instruction because this instruction should not be given.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	CRIMINAL NO. 99-00239ER
vs.	)	
MICHAEL H. BOULWARE,	)	– VOLUME 2 –
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Tuesday, June 28, 2005, at 9:15 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
KELVIN H. KANESHIRO, ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[161] BY MR. O'CONNOR:

Q. In any event, from the standpoint of the corporate books, all the tax problems had been taken care of by you; is that right?

A. By the pickup of the income –

Q. Yes.

A. – the over-reporting of the income?

Q. Yes.

A. Uh-huh.

Q. Okay.

Now let's shift to Mike Boulware.

You've done Mike Boulware's personal taxes for many years now; is that right?

A. That's right.

Q. In the time that you have done Mike Boulware's personal taxes, has the company, HIE, had earnings and profits, in a general sense?

A. No.

Q. In doing Mike Boulware's taxes, did you – you knew, in each year, that the company had no earnings and profits; is that right?

MR. DWYER: Objection, Your Honor. Relevance?

THE COURT: Overruled.

BY MR. O'CONNOR:

Q. Have you been called upon to render an opinion, in any [16] regard, regarding Mike Boulware's income and its relationship to the earnings and profits of the company?

A. No.

Q. When should tobacco taxes be picked up as income if they are overpaid?

A. If they are overpaid?

MR. DWYER: Objection, Your Honor; vague. I think there's federal taxes, I think there's state –

THE COURT: Do you understand the question?

THE WITNESS: I don't really –

THE COURT: Restat your question.

MR. O'CONNOR: Yes.

BY MR. O'CONNOR:

Q. In this situation, HIE is in the tobacco business, right?

A. Yes.

Q. They sell a large amount of tobacco every year; is that correct?

A. That's correct.

Q. For the tobacco that HIE sells every year, state taxes must be paid on that tobacco sale, right?

A. Exactly.

Q. Are you familiar with the fact that HIE at some point realized that they had been paying taxes at the wrong time on tobacco taxes?

A. Yeah. I'm not – I'm not – yes, I do, in concept. I

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff,	) CRIMINAL NO. 99-00239ER
vs.	)
MICHAEL H. BOULWARE, Defendant.	) - VOLUME 3 -

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Wednesday, June 29, 2005, at 9:03 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
KELVIN H. KANESHIRO, ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[138] All rise.

This court will be in recess for a short recess.

(A recess was taken from 1:57 to 2:02 p.m.)

(The following proceedings were held in open court, in the presence of the jury:)

(Mr. Manago resumed the witness stand.)

THE COURT: All right, continue your examination of this witness.

BY MR. OSBORNE:

Q. Mr. Manago, the capital account is where contributions from the shareholders went. Do you agree with that?

A. Yes.

Q. With that understanding, was there any return to shareholders out of the capital account during the years '89 through '97?

A. No.

Q. And, about these lease payments, were any entries made in the loans to shareholders to compensate for these lease payments?

A. Yes.

Q. What was done to the loans to shareholders?

A. We reversed the rental expense, and charged the officer loan account.

Q. When did you do that?

Let me be more direct: Was that part of the

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	CRIMINAL NO. 99-00239ER.
vs.	)	
MICHAEL H. BOULWARE,	)	– VOLUME 4 –
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Thursday, June 30, 2005, at 9:15 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
KELVIN H. KANESHIRO, ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[109] THE COURT: Well, that's all only relevant if he overlooked something by not following the lead.

But you may step down, ma'am.

MR. OSBORNE: Your Honor, on another matter, just to make a record:

Could I just put on the record, Your Honor, that there was an objection by the defense which the court overruled as to Exhibits 700 through 711.

I had failed to say at the time I offered them they are offered pursuant to Rule 1006.

THE COURT: Well –

MR. OSBORNE: I'm sure the court knew that.

THE COURT: – I assumed that.

MR. OSBORNE: Okay.

THE COURT: I want to rule on this motion, because I think it will relieve – or move things along.

The government has filed a motion in limine to exclude evidence that Hawaiian Island Enterprises over-reported its income, claiming that it is irrelevant because Hawaiian Island Enterprises and Boulware were separate taxpayers.

The defendant has filed an opposition, in which he raises two separate arguments:

First, the defendant argues that Boulware was authorized by Hawaiian Islands' board of directors to expend [110] the funds at issue in furtherance of corporate objectives.

The thrust of this argument seems to be that the money was never income to Boulware; it was the property of the corporation.

However, even if true, the court does not see how this argument is relevant to Hawaiian Island Enterprises' over-reporting of income.

The issue of whether Hawaiian Island Enterprises over-reported its income is completely independent to the issue of Boulware's authorization to expend money on behalf of the corporation.

Second, the defendant argues that Hawaiian Island Enterprises' income is relevant because it determines whether a corporate distribution to Boulware was out of its earnings and profits, and hence, a taxable dividend, or simply a non-taxable return of capital.

The Ninth Circuit, however, explicitly rejected this argument in Boulware's appeal, in United States versus Boulware. In that case, the court stated regarding an argument of insufficiency of the evidence, quote:

"The sufficiency of the evidence issue boils down to whether the government could have proved the elements of Section 7206-1 and 7201 beyond a reasonable doubt without proving either that Boulware stole the funds from Hawaiian Island Enterprises or that funds were not loans or non-taxable [111] returns of capital."

They continued:

"United States versus Miller, 545 F.2d, 1204, Ninth Circuit, 1976, indicates that the answer to this question is yes.

"Because the government could prove the elements of proof beyond a reasonable doubt without showing that the funds were a non-taxable return of capital, Hawaiian Islands Enterprises' over-reporting of income is simply irrelevant."

Therefore, the motion to exclude this evidence of alleged over-reporting of income is granted.

MR. KANESHIRO: Your Honor, may I be heard on that?

THE COURT: Yes, you may.

MR. KANESHIRO: First of all, as to the one part – Mr. Yamachika just testified –

THE COURT: Come up here.

MR. KANESHIRO: Oh, I'm sorry (approaching podium). Sorry, Your Honor.

Mr. Yamachika's just testified that, based on his bank deposit method, he traced or he looked at certain funds that went into two bank accounts that he claims or that the government is contending was never reported by the corporation, never recognized by the corporation as income. To that point, the over-reporting of income for those years is part of our defense that, in fact the [112] corporation did recognize it.

The fact that Mr. Manago may not have consciously known what the income was doesn't necessarily mean that the corporation did not report the income.

Because Mr. Boulware understood and told Mr. Manago to book certain income. So that's part of the defense of establishing –

THE COURT: Well, you've got to present these defenses. They can't be inferred. You haven't presented any defense yet.

MR. KANESHIRO: Well, that's the point. If you are going to do a motion in limine right now, you prevent us from doing it in our defense.

THE COURT: Well, a motion in limine means that during the prosecution's case, you should not be allowed to go into this.

Now, that may change depending on what evidence you present.

MR. KANESHIRO: I see. So the motion in limine –

THE COURT: You are entitled to explain what the government is relying upon here to convict your client. If you have explanations that can be given through competent witnesses, they may be presented.

But it seems to me that that issue of –

You see, in other words, you're entitled to present [113] this kind of defense if you think you can; that is, if it was a – if there was really anybody followed it at that time.

If it's merely an attempt to explain away what has happened by something that really didn't happen, then it's a phony defense.

MR. KANESHIRO: But, Your Honor, as I understand it, the court is looking at this motion in limine only as to the evidence being brought in the prosecution's case.

THE COURT: Well, no, that's not true. I'm saying this is not relevant, in the view of the court, and I have granted their motion to exclude it.

Now, if the posture of the evidence changes, for example, if we had evidence that the board of directors met and made a decision that this was to be treated in this way and that this money was to be

treated as non-taxable returns of capital, that's fine; you can present that kind of evidence.

MR. KANESHIRO: Your Honor, that evidence is already in front of the jury.

THE COURT: The government's case is in front of the jury; yours isn't.

MR. KANESHIRO: So I just want to make clear that we may be able to produce this type of evidence in our case; we are not foreclosed from doing that?

MR. KANESHIRO: Look, I'm not going to tell you how [114] to put on a defense.

But my ruling now is that this evidence is irrelevant.

MR. KANESHIRO: On the state of the evidence as it now stands?

THE COURT: Well, it's irrelevant for the reasons that I stated: That the government can prove these charges without the need to show this –

Once they have proved a prime facie case, what they think is a prima facie case of unreported income, then the defendant has the opportunity to respond to it and to present evidence to explain it away.

MR. KANESHIRO: But at this point, as I understand the court's ruling, we can't even put on that evidence.

THE COURT: The ruling stands. Unless the court makes a further ruling.

So there is to be no such evidence without further order from the court.

MR. KANESHIRO: Your Honor, as I understand it, the ruling in the Boulware case, the court only said that, as far as the sufficiency of the evidence was concerned, this may not be part of it.

But that's only as to the government's prima facie case. It says nothing about our defense.

THE COURT: Your problem is that you have been [115] trying to prove your defense through the government's witnesses. I suggest you prove it through your own witnesses.

MR. KANESHIRO: I just want to make clear that –

THE COURT: That works much better.

MR. KANESHIRO: – in our part of the case, we are not foreclosed from going into this evidence.

THE COURT: You don't have to put on any case at all if you don't want to.

MR. KANESHIRO: I understand that.

THE COURT: You understand that.

MR. KANESHIRO: But I just want to make clear that this order does not foreclose us from putting on such evidence in our case.

THE COURT: It does foreclose you unless there is a further order to the contrary.

So you can't put it on without first giving the court – making a request to the court to put it on, and explaining why this order should not be in effect for some kind of evidence that you intend to present.

That's all, counsel.

MR. KANESHIRO: Thank you, Your Honor.

THE CLERK: All rise.

Court will be in recess until 1:30 p.m.

(The lunch recess was taken at 12:12 p.m.)

* * *

REINWALD O'CONNOR & PLAYDON LLP
A Limited Liability Law Partnership

DENNIS E. W. O'CONNOR 561-0
24th Floor, Makai Tower
Pacific Guardian Center
733 Bishop Street
Honolulu, Hawaii 96813
Telephone: (808) 524-8350

Attorney for Defendant
MICHAEL H. BOULWARE

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CR NO. 99-00239 ER MEMORANDUM IN OPPOSITION TO MOTION IN LIMINE TO PRECLUDE DEFENDANT FROM INTRODUCING EVIDENCE, TESTIMONY AND ARGUMENT RELATING TO THE ISSUES OF CONSTRUCTIVE DIVIDENDS AND RETURNS OF CAPITAL FILED ON JUNE 30, 2005; CERTIFICATE OF SERVICE HEARING DATE: TIME: JUDGE: EDWARD RAFEEDIE TRIAL DATE: JUNE 27, 2005

MEMORANDUM IN OPPOSITION TO MOTION IN LIMINE TO PRECLUDE DEFENDANT FROM INTRODUCING EVIDENCE, TESTIMONY AND ARGUMENT RELATING TO THE ISSUES OF CONSTRUCTIVE DIVIDENDS AND RETURNS ON CAPITAL FILED ON JUNE 30, 2005

(Filed Jul. 01, 2005)

Relying upon a misreading of *U.S. v. Miller,* 545 F.2d 1204 (9th Cir. 1976) and *U.S. v. Boulware,* 384 F.3d 794 (9th Cir. 2004), the government moves this Court *in limine* to preclude the introduction or argument of evidence concerning constructive dividends and returns of capital. The government erroneously argues that *Miller* and *Boulware* foreclose Defendant Michael H. Boulware from arguing that the allegedly diverted funds constitute a constructive dividend or a return of capital. More specifically, the government argues that since *Miller* and *Boulware* hold that the government only needs to prove the taxpayer assumed control of funds and a failure to report said funds to show tax evasion under the statutes, evidence of constructive dividend or return of capital is irrelevant.

However, the government misconstrues, misapplies and misstates the holdings of *Miller* and *Boulware.* In particular, the Ninth Circuit in *Miller* noted that introduction of such evidence is on a case by case basis. In *Miller,* the Ninth Circuit plainly concluded "that whether diverted funds constitute constructive

corporate distributions depends on the factual circumstances involved in each case under consideration." 545 F.2d 1214-15.

> The Ninth Circuit further explained in *Miller* that
>
> [i]n holding that the constructive distribution rules should not automatically be applied, it is not herein asserted that diverted funds could never be a return of capital. However, to constitute the latter, there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be such a return.

Id. at 1215.

Thus, the Ninth Circuit made clear in *Miller* that whether allegedly diverted funds constitute constructive corporate distributions must be decided on a case-by-case basis with "some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be such a return." Defendant Boulware will present evidence that the allegedly diverted funds were HIE monies used by Defendant Boulware for corporate purposes and that such use of the funds by Mr. Boulware was recognized and approved by HIE as established by the government's own exhibits in evidence, Exhibits 63A and 63B. Those exhibits prove that in 1990 and 1991, before the IRS began its investigation of Defendant Boulware, the directors of HIE had already authorized its President, Defendant Boulware, "to use funds of the Corporation for the purpose of establishing new

business ventures for the Corporation and will account four such funds as an advance, including actions to establish the coffee and real estate business to be accounted for once established and turned over to the company." Government's Exhibit 63B. Thus, according to *Miller*, the question of whether the allegedly diverted funds may be treated as constructive corporate dividends or return of capital is a factual issue for the jury that Defendant Boulware is entitled to develop in his case-in-chief.

In *Boulware,* the Ninth Circuit never ruled that the characterization of the allegedly diverted funds as constructive dividends or return of capital or corporate loans was irrelevant. Instead, the Ninth Circuit, in determining whether the government had met its prima facie burden, concluded that the government was not required to prove that the allegedly diverted funds were not loans. The Ninth Circuit, citing *Miller,* noted that "the defendant had the burden of going forward once the government 'demonstrates that the taxpayer had unexplained funds which *could be considered* as income which the taxpayer fails to report in his return.'" 384 F.3d at 811.

In other words, the Ninth Circuit placed the burden of proving the characterization of the allegedly diverted funds upon the defendant. The Ninth Circuit did not, as the government contends, rule that the characterization of funds as constructive dividends or return of capital or corporate loans was irrelevant. It merely shifted that burden the defendant once the government established its prima facie case.

It is also important to note that in the *Miller,* the Ninth Circuit concluded that the defendant was factually precluded from arguing that the moneys were constructive dividends because the defendant Miller admitted that he was not a shareholder of the subject corporation. Therefore, the Ninth Circuit concluded that the corporate distribution rules could not apply to him because "the only capacity in which Miller was entitled to receive the diverted funds was as an employee-officer of the corporation." 545 F.2d at 1215.

Here, it is undisputed that at all times relevant, Boulware was a shareholder of HIE and therefore, could be entitled to received funds from HIE as a corporation distribution. In *Davis v. United States,* 226 F.2d 331 (6th Cir. 1955) the Sixth Circuit Court noted that "money received by a corporation was not income to an individual unless the corporation funds were in some way transferred or diverted to the individual, and became property over which he exercised dominion and control and treated as his own, to ***the exclusion of any interest therein by the corporation***. . . ." Id. at 334; emphasis added. In *Miller* the allegedly diverted funds "were not recorded as sales on the corporate books, or reported in the corporate tax returns" nor were they reported as income by the individual taxpayer. In other words, neither the corporation nor the individual shareholder reported the income. Therefore, the issue before the Ninth Circuit was who should have reported the income.

In the present case, however, Defendant Boulware will prove that HIE reported the allegedly diverted funds as income on its corporate tax returns. Mr. Boulware will also prove that there was corporate recognition that he would be using corporate funds to develop various business ventures. Therefore, it is Defendant Boulware's position that whether the corporate funds he used could be characterized as constructive dividends, return of capital, corporate loans or corporate advances is a question of fact for the jury to decide as a part of his defense to the charged crimes.

The government's reliance on *Miller* is also misplaced because *Miller* was decided prior to the tax court opinion in *Truesdale v. Comm.*, 89 T.C. 1280 (1987) and prior to the IRS's Action on Decision 1988-025 in which the IRS agreed with the reasoning of the Tax Court in *Truesdale.* After the *Truesdale* decision, the IRS changed its policy to reflect a "no earnings and profits, no income" approach that markedly differs from *Miller.* In 1988, the Tax Litigation Division of the Internal Revenue Service issued an Action on Decision that stated:

> Funds diverted to the shareholder of a wholly owned corporation should be regarded as constructive distributions, unless the funds were additional salary or otherwise were received in a nonshareholder capacity. The funds should be included in the income of the corporation and taxed to the shareholder in accordance with I.R.C. [§] 301(c).

> *When such funds are received in a shareholder capacity, we will no longer argue they are ordinary income regardless of earnings and profits.* (emphasis added).

Action on Decision, CC-1988-025, 1988 AOD Lexis 22.

Under the "no earnings and profits, no income" rule, diverted corporate funds are treated as a constructive dividend to the shareholder to the extent the corporation had earnings and profits. To the extent that a corporation's distribution to a shareholder is *not* made out of earnings and profits, I.R.C. § 301(c)(2) treats the distribution as a return of capital to the shareholder that is applied against and made in reduction of the adjusted basis of the shareholder's stock; or, if applicable, the distribution is treated as a return of a loan.

It is axiomatic that criminal tax law must follow civil tax liability. Otherwise, it would lead to the absurd result that a taxpayer could be found criminally liable based on his tax return for a particular year when the same return would be acceptable under the prevailing interpretation of civil tax law. Yet that would be the case if this Court applies *Miller* with the broad brush that the Government suggests without distinguishing its facts and recognizing the interpretation given the tax code in the civil enforcement context by the Tax Court and the IRS in decisions reported after *Miller.*

More recent decisions from other jurisdictions have so recognized. In *U.S. v. D'Agostino,* 145 F.3d 69

(2nd Cir. 1998), the Second Circuit explained as follows:

> In *Williams,* the Eleventh Circuit held that, in criminal tax evasion cases, the government is not required to characterize diverted income and therefore need not prove that diverted Finds constitute a constructive dividend or that the corporation had any earnings and profits. *Id.* at 851-52. Instead, the government need only show the taxpayer had actual command over the funds. *Id.* at 850 (quoting *Davis v. United States,* 226 F.2d 331, 335-36 (6th Cir. 1955), cert. denied, 350 U.S. 965, 73 S.Ct. 432 (1956)). We decline to adopt this approach. . . . Furthermore, we believe the rule of this Circuit is better reasoned. The *Williams* rule purports to minimize the government's burden of proving a tax deficit and places greater emphasis on the intent element in criminal tax evasion cases. **The apparent result,** however, is that the **government bears a higher burden of proof in a civil tax collection matter than in a criminal tax evasion prosecution.** In addition, the approach taken in *Williams* and *Davis* **effectively eliminates proof of a tax deficiency as an element of a 26 U.S.C. § 7201 violation.** Under the *Williams* rule, the government would only need to prove that the taxpayer willfully intended to exercise domain and control over the diverted funds and took affirmative acts to evade paying taxes. **If Congress intended this showing to**

> **suffice to establish a violation of § 7201, it would not have included a tax deficit as a requisite element.**
>
> We have little doubt the D'Agostinos acted with bad intentions. Anne Marie hid, in total, $400,000 in large bills in her kitchen drawers and failed to reflect the diverted corporate funds in Koin Key's corporate books. It is entirely possible the D'Agostinos intended to evade paying taxes on the diverted funds. However, bad intentions, alone, are not punishable. **The diversion of the funds cannot constitute a criminal offense, despite criminal intent, if no taxes are due.**

Id. at 73.

Moreover, when the government seeks to rely on a taxpayer's control of funds to prove that the taxpayer has received taxable income, **"[s]uch control must be to the exclusion of any of the rights in the money asserted by the corporation."** *United States v. Toushin,* 899 F.2d 617, 622 (7th Cir. 1990). The owner of a wholly owned business may "take the money for a number of legitimate reasons," as the government itself argued in *Toushin. Id.* at 622.[1]

Finally, the government claims that no foundation has been laid pursuant to *Miller* for introduction of evidence pertaining to the defenses of constructive dividends or return of capital. However, the government just rested its case-in-chief and Defendant Boulware has not as yet been given the opportunity

to present its defense case. Therefore, for the Court to preemptively preclude Defendant Boulware from laying the very foundation that the government argues is lacking would be highly prejudicial and premature.

Neither *Miller* nor *Boulware* holds that a corporate dividend or return of capital defense is never relevant to a tax evasion charge. In fact, *Miller* makes clear that the contrary is true; i.e., "that whether diverted funds constitute constructive corporate distributions depends on the factual circumstances involved in each case under consideration." 545 F.2d 1214-15.

For the foregoing reasons, Defendant Boulware respectfully submits that the government's motion must be denied.

DATED: Honolulu, Hawaii, July 1, 2005.

/s/ [Illegible]
DENNIS E. W. O'CONNOR
Attorney for Defendant
MICHAEL H. BOULWARE

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	)	CRIMINAL NO. 99-00239ER - VOLUME 5 -

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Friday, July 1, 2005, at 9:11 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
KELVIN H. KANESHIRO, ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[6] second year of leave. And then I resigned, formally, in '89.

Q. At that time what was Michael's position? Michael, your brother.

A. He was the president and owner of the company.

Q. Had he established the company?

A. Yes.

Q. And, in establishing the company – well, what did this company start as?

A. The company started primarily in 1981, heavily into the video games. Slowly, after that –

THE COURT: The question was when, and you've answered that.

BY MR. O'CONNOR:

Q. When the company started, how many employees did it have?

A. Two, three, four.

Q. And where was it located?

A. Either on – originally, I believe it was in the back room on Kapiolani Boulevard.

Q. How many employees does the company have today?

A. Over 220.

Q. And where are you located today?

A. On every island: Maui, Kauai, the Big Island, and Oahu.

Q. Is your home office on Oahu?

A. Yes.

Q. And where is that?

* * *

[17] Q. Now, Mr. Manago has testified in this courtroom that there were certain bank accounts that were operated by Michael that Manago had no knowledge of.

If Manago did not know about a bank account, does that indicate that no one in the corporation knew about it?

A. Could you say that again?

Q. Yeah.

Does Manago's lack of knowledge of a bank account –

MR. DWYER: Objection, Your Honor; calls for speculation.

THE COURT: Sustained.

BY MR. O'CONNOR:

Q. Did you have a rather firm knowledge, in the years 1992 through today, of the financial situations of the company?

A. Yes.

Q. And did you follow it on a regular basis?

A. Yes.

Q. Did you know that Mike Boulware was – your brother – was spending company money for various things like we just talked about, the coffee buying, but other things, too?

A. Probably. I can't remember.

Q. Well, there came a time, for example, when you established a water company; is that right?

A. Yes.

Q. And that water company bottles and sells Hawaiian water; [18] is that correct?

A. Yes.

Q. You can find these in almost every supermarket in Honolulu, right?

A. Throughout the state.

Q. And on the mainland, too?

A. Very sporadic on the mainland.

Q. How about the commissaries?

A. Only in the state of Hawaii.

Q. Okay.

But you can find these bottled water from Hawaiian Isles in quite a few places; is that right?

A. Yes.

Q. Is that a growing business today?

A. Yes.

Q. Was that business established by Mike Boulware?

A. Yes.

Q. After he established the business –

MR. O'CONNOR: Well, strike that.

BY MR. O'CONNOR:

Q. In establishing the business, do you know where Mike got the money to build the plant and get the business going?

A. From the company. I'm not sure.

Q. You say from the company. Do you know how the company got the money to Mike?

[19] A. Could be officer loans.

Q. Was there a time when Mike turned that business, the water business, back to the company?

A. Yes.

Q. When he turned it back to the company, was any money paid to Mike?

A. No.

Q. We were talking a little bit about the Kona coffee business.

Did Mike eventually put together a wholesaling operation for purchase of Kona coffee in Kona?

A. I'm not sure.

Q. Who would know that? Mike?

A. Well, he should.

THE COURT: That's rather difficult for this witness to answer who would know that.

MR. O'CONNOR: You're right, Your Honor, obviously.

BY MR. O'CONNOR:

Q. But such a business does exist, does it not, the business for the acquisition of Kona coffee in Kona?

A. Are we talking about current? Or previous?

Q. Both.

A. Yes, there is.

Q. And do you folks get your coffee through that system?

A. Yes.

[20] Q. And did Mike put it together?

A. Yes.

Q. Did there come a time when Mike turned that business, if you will, back to the company?

A. Yes.

Q. Did he get paid any money for that?

A. Not that I know of.

Q. Where did the money come from for Mike to establish that business?

A. The company.

Q. Okay.

Do you know Mal Sun Boulware?

A. Yes.

Q. Who is that?

A. It was Michael's former wife.

Q. Are they now divorced?

A. Yes.

Q. Was that a pleasant divorce or a difficult divorce, from your observation?

A. I think it was a costly divorce.

Q. Costly to whom?

A. Michael.

Q. Did the company also have to come up with some money regarding that?

A. I know it cost the company money, yes.

* * *

[38] A. Not to my knowledge.

Q. So, when you say that she was going to get part of the company as part of the divorce, really Mike had all the stock in the company, right? You owned some.

A. I believe he had all the stock.

Q. Okay.

And so the only interest that she was going to get was whatever property Mike had, correct?

I mean, she couldn't go to the company and say I want some of – 50 percent of the company?

A. I'm under the assumption that, because of their marriage, she's entitled to 50 percent of –

Q. His property.

A. – whatever's been accumulated.

Q. Which would be the stock in the company, correct? Mike's property.

MR. O'CONNOR: I object, Your Honor.

THE COURT: Well, we are getting into legal questions here –

THE WITNESS: I'm not a lawyer.

THE COURT: – of what she's entitled to.

This witness should be asked about his knowledge of those things, if any.

MR. DWYER: Sure.

BY MR. DWYER:

* * *

[65] THE COURT: Well, are you trying to qualify this witness as an expert witness?

MR. O'CONNOR: I'm just trying to show his background, Your Honor, so I can ask him a question about divorce work.

THE COURT: Well, I think the objection is sustained.

You can ask him about his own background –

MR. O'CONNOR: I will do that.

THE COURT: – he already testified to that.

BY MR. O'CONNOR:

Q. In the work that you've done in divorces, have you been required to handle property divisions?

A. I've never seen a divorce without a property division, in the hundred or so that I've handled.

Q. Are you familiar with the law of Hawaii as it involves property divisions between divorcing wives – or divorcing spouses?

A. I feel I'm quite familiar with what the law has been and what it currently is.

Q. Were you the attorney for Michael Boulware in the scope of his divorce from Mal Sun Boulware?

A. Yes, I was.

Q. Was there property involved in that divorce?

A. Quite a substantial amount of property.

[66] Q. And do you remember what the property was?

A. I do.

Q. What was the property involved?

A. The property basically consisted of two assets: One was a house that the two of them had lived in; and the other was Hawaiian Isles Enterprises, an ongoing business. That was one of the major, major assets that had to be looked at to determine who was going to get what.

Q. Did the wife, Mal Sun Boulware, have a claim in the divorce action as to Hawaiian Isles Enterprises?

MR. OSBORNE: Objection; leading.

THE COURT: Overruled.

A. There was absolutely no doubt in my mind that she had, by way of a –

THE COURT: Well, the question was –

THE WITNESS: Yes.

THE COURT: – did she make a claim in that case.

THE WITNESS: Yes, she did.

THE COURT: All right.

BY MR. O'CONNOR:

Q. And was that part of the divorce debate between husband and wife in that case?

A. Yes, it was.

Q. Was it required that a value be established for the company?

* * *

[71] Isles?

A. In the neighborhood of $3.5 to $3.6 million, from what I can recall.

Q. Now, that $3.5 to $3.6 million, why was that attributed to her? Why did she have that interest in Hawaiian Isles?

A. I originally explained to the client Mike, that in a long-term marriage, in the state of Hawaii, from my experience in the law, that whatever the spouses accumulate together during the term of the marriage, each has an interest – a marital interest in that asset.

And since Hawaiian Isles Enterprises became a success during the term of their marriage, and had become quite successful as far as an operating company, then she would have – whether the stock was in her name or not – she would have a one-half interest, equitable interest, however you want to term it, a one-half interest in that company.

Q. Now, there was no stock in her name; is that correct?

A. There was none.

Q. So she held this interest because she was his wife at the time the company was formed and progressed; is that correct?

A. That's correct.

Q. Was this agreement included in the decree?

A. Yes, it was. I believe by reference as to its date and things of that nature. But it was part of the decree.

Q. The $3.6 million, was that broken out into a payment [72] schedule of some sort?

A. I know there's an exhibit attached to the agreement as far as payments.

Q. And that exhibit is attached to the settlement agreement?

A. Yes. That's correct.

I just don't recall, sitting here right now, if I would –

Apparently on the last page, it does indicate that the total payments made from '94 through '99 would be $3,650,000.

Q. Now, the decree and the settlement agreement were between Mike Boulware and Mal Sun Boulware; is that correct?

A. That's correct.

Q. Did Mike ask you any questions about Hawaiian Isles' position in this and whether or not they should or could pay this amount of money to Mal Sun?

A. Yes, he did. He basically asked that exact question.

Q. And what did you reply to Mr. Boulware?

A. Well, I told him, from two respects:

One, if you have a person that you are divorcing, the probabilities of her being a person you could work with, if she got her marital interest in the corporate stock, would probably be, you know, pretty slim to

none; and it would behoove him to have the company, Hawaiian Isles Enterprises, basically be the entity that would buy out her claim, whatever [73] her claim consisted of, a marital interest, whatever, to buy her claim out, in order to keep the company running smoothly.

Q. And what – did Mike take any steps to have the company buy her claim out?

A. I believe that's what occurred.

Q. And, again, why did you believe the company should buy this out?

A. One thing you don't want in a – from my experience; and I explained this to Mike – one thing you don't want in a company where one person is a driving force is to have a receiver appointed to represent the wife's interests or to have her actually try to perfect her interests, because business will not go forward as smoothly as it should.

And I felt that was the interest of Hawaiian Isles, why they should buy it out. And I suggested that they do buy her out.

Q. You suggested Hawaiian Isles buy her out?

A. Yes.

Q. And, to your knowledge, they did; is that correct?

A. That's my understanding.

Q. All right.

I want you to shift your interest for a minute to another subject matter.

THE COURT: Well, let's take our morning recess at this time.

[74] THE CLERK: All rise.

Jurors, right this way, please.

(A recess was taken from 10:37 to 10:58 a.m.) (The following proceedings were held in open court, in the presence of the jury:)

THE COURT: You may continue.

MR. O'CONNOR: Thank you, Your Honor.

BY MR. O'CONNOR:

Q. Mr. McCarthy, did there come a time when Mr. Boulware asked you to do some legal work regarding a trust for his son?

A. Yes, there was.

Q. What occasioned that, if you know?

A. I –

THE COURT: Well, that question's not clear, what occasioned it.

BY MR. O'CONNOR:

Q. Why did he do that?

A. Well, what I was told by Mike at the time was that – what I was told was that he and Mal Sun had not had any children, and he had a child with another person, and that he wanted to basically take care of the child's future by way of setting up a trust.

And we had a number of meetings at my office where that subject matter was discussed. And eventually a trust was created for his son Glenn.

[75] Q. And the boy's name was Glenn?

A. Yes.

Q. Did he discuss with you at that time what should be placed into the trust?

A. Yes.

Q. And what was that – what did he suggest or did you suggest be placed in the trust?

A. I remember we talked about it. He was obviously – he basically said what a lot of dads say, I'm building the company for my kids and I want half the stock, if I remember properly, to go in – half the stock in HIE, Hawaiian Isles Enterprises – and some, if I remember properly, a relatively minimal amount of cash to open a bank account, that type of thing.

Q. Did you do a trust?

A. Yes, I did.

Q. I ask you to look at Exhibit 1005, which is in that file before you. It's the first document.

A. (Perusing documents.)

I have it in front of me.

Q. Is this the trust that you created?

A. Yes.

Q. This is dated September the 8th, 1987; is that correct?

A. That's correct.

Q. Who is the trustor, or the person who is going to hold [76] this stock in – for the trust? Who is the trustor of the trust?

A. Jin Sook Lee.

Q. And is that Glenn's mother?

A. Yes.

MR. O'CONNOR: Your Honor, at this time we offer Exhibit 1005 into evidence.

THE COURT: That may be admitted.

(Exhibit 1005 received in evidence.)

BY MR. O'CONNOR:

Q. Did Mr. Boulware have further discussions with you about the role of Ms. Lee as trustee?

A. Well, there was a point in time when we, Mike and I, had discussed the possibility of various monies going to Jin Sook Lee from Hawaiian Isles

Enterprises. And I provided him with some advice concerning what her obligations were.

Q. What was the purpose of that money that was going to go to her from Hawaiian Isles Enterprises?

A. To buy back the stock that I had said that Mal Sun would have either an equitable interest in or a marital interest in, that it was to go back – the cash was to go back to Hawaiian Isles, and that would be used to retire the stock interest, or to buy her claim out, so to speak.

Q. So this was going to be Hawaiian Isles' money, to buy out the domestic claim that she had to the company; is that [77] correct?

A. That's correct.

Q. Did something take place in that area? Did they start putting money somewhere?

A. From what I could recall, a substantial amount of money was given to Jin Sook under those terms, and that the money was to sit, intact, until the divorce and a number of other things had been resolved, and then given back to HIE, to close the buy-back of the stock.

Q. Buy-back of Mal Sun?

You told us earlier that she, Mal Sun Boulware, didn't have any stock in HIE; is that correct?

A. Not in a technical-technical sense. But since she was the spouse of Mike when the company was created and when it flourished, she would have this marital interest in it.

So that at the time of the divorce, if it was a contested divorce, the court in my mind would, black-and-white, award her 50 percent of the stock in HIE.

Q. To her?

A. To her.

Q. All right.

A. Or 50 percent of the value of the company to her. One or the other.

Q. Did Mr. Boulware ask you what capacity Jin Sook Lee would be in if she held this money to buy out Mal Sun's interest?

[78] A. He did.

Q. And what did you tell him?

A. I told him that she would have to hold it as a trustee, she had various fiduciary duties, since the beneficiary of the trust was Glenn, her son, and she knew darned well from the beginning what the purpose of the money was and what it was to be used for, that she would be either an out-and-out trustee for those funds or a constructive trustee, and they had to be held, intact, to be used for the purposes for which they were designated.

Q. Now, shifting to a different subject.

Did there come a time when Mr. Boulware asked for your advice concerning tobacco taxes and the payment of the tobacco taxes to the State of Hawaii?

A. Yes, he did.

Q. And what was the nature of –

MR. OSBORNE: Your Honor, I am going to object to the relevance of this question.

THE COURT: Well, it does not appear relevant.

MR. O'CONNOR: All right, let me lay a little foundation with the witness, Your Honor.

THE COURT: Well, let's do that.

BY MR. O'CONNOR:

Q. Was HIE required to pay taxes on tobacco sales and purchases in the state of Hawaii?

* * *

[88] Q. All right.

Now, about the trust – (perusing documents) – about the trust:

You set up a fully documented trust – we have it now in evidence – where the trust running in favor of the son; is that correct.

A. Yes.

Q. And it provided for the deposit of shares, and the opening of a bank account, and the transfer of some money?

A. Yes.

Q. And that was all to Jin Sook Lee?

A. For the benefit of the son. Yes.

Q. Right.

Now, you didn't set up a trust in which monies were transferred to Jin Sook Lee for the benefit of Mal Sun Boulware on the occasion of her divorce, did you?

A. No.

Q. And, in fact, the money that was transferred to Jin Sook Lee went in a safe in the floor of the house, didn't it?

MR. O'CONNOR: I object, Your Honor. There's no evidence of that yet.

THE COURT: Overruled.

If you know, you may answer.

A. I don't know where it went. All I know is that money was transferred for the purposes I described earlier.

[89] BY MR. OSBORNE:

Q. And did you see that a bank account was opened?

A. No.

Q. And there were absolutely no legal documents prepared by you concerning this arrangement, the transfer of money to Jin Sook Lee for Mal Sun's benefit?

A. The trust.

Q. The trust was in favor of whom?

A. It was in favor of Glenn.

Q. All right.

A. Glenn was a 50 percent shareholder of the company –

Q. Listen to my question:

You drafted no documents appointing Jin Sook Lee the trustee for the benefit of Mal Sun Boulware, did you?

MR. O'CONNOR: Asked and answered, Your Honor.

THE COURT: Yes, it has been.

MR. OSBORNE: Well, I –

THE COURT: It's been asked and answered.

MR. OSBORNE: I'm not sure he's given us a clear answer, Your Honor. I think it calls for a yes or no.

THE COURT: Well, you didn't prepare any such documents?

THE WITNESS: A clear "no." I did not. I was not requested to.

THE COURT: All right.

* * *

[160] and not to form or express any opinions or conclusions about this case until it has been submitted to you.

You are excused.

THE CLERK: All rise for the jurors.

(The jury was excused at 1:14 p.m.)

(The following proceedings were held in open court, outside the presence of the jury:)

THE COURT: I can think of no conceivable theory of admissibility for this group of documents labeled Exhibit 2010, because it is a conglomerate of things, including deposition testimony, including copies of checks, including statements of banks, etc.

So the court will – that will not be the last word.

If you file with me a justification to admit this under some pertinent evidentiary rule, I will consider it. But, as of now, I'm not –

And you're the one that objected to it. You should file whatever objection that you have, other than your – other than that you don't like it.

MR. DWYER: Yes, Your Honor.

THE COURT: That is not a good objection. Which both sides have used.

Now, the other issue:

One other issue, that the government has filed a motion in limine to preclude the introduction of evidence [161] relating to the issues of constructive distribution and return of capital.

This motion would prevent the defendant from arguing that monies diverted from Hawaiian Island to Boulware were actually a return of the defendant's capital investment in the company.

I want to quote to you now from a case, which I will cite in a moment:

"Evidence of unexplained funds in the taxpayer – of the tax – in the hands of the taxpayer establishes a prima facie case of understatement of income, making it incumbent on the taxpayer to overcome the logical inferences drawn from the facts proved," end quote, United States versus Garcia, 412 F.2d, 999, cited with approval by the Ninth Circuit in United States versus Miller, 545 F.2d, 1204.

Once the government had made out a prima facie case, in order for constructive distribution rules to apply, I quote again. This is from Miller .

Quote, "There must be some demonstration on the part of the taxpayer and/or the corporation that

such distributions were intended to be such a return," end quote. Miller.

Now, as Miller held, it is not relevant whether the funds could have been classified as return of capital or a dividend at the time they were diverted.

There is a violation given where the diverted funds [162] could have qualified as a return of capital, when the taxpayer fails to report the money as income or record it as a return of capital on the corporate books.

Here, the government has made out the prima facie case required by Miller.

Thus, if the constructive dividend rules are to apply, the defendant must make the requisite showing that the distributions were intended to be a return of capital.

As the government points out, Mr. Manago, who was a witness, who was an employee of the defendant, has testified that there were no returns of capital during the years in question.

Unless the defendant introduces competent evidence that demonstrates otherwise, the constructive distribution rules would apply to this case – would not apply.

Because of the confusing and potentially prejudicial nature of this evidence, the court believes the matter should be resolved either in a hearing under Federal Rule of Evidence 104, which is to determine

the existence of the preliminary facts necessary for admissibility, or if the defendant can make a showing by a written offer of proof, which the court will then consider in determining this issue.

So, what we will do is this:

We will probably hold a hearing.

I'll give you the choice. If you want to present [163] the evidence to the court outside the presence of the jury to demonstrate what I have just said, then I will consider that, and rule accordingly on the issue.

The court cannot rule at this point in time; in other words – for the reasons I have stated.

All right. Now, I think that that is all. We will reconvene on Tuesday, at 9:00 a.m. Try not to blow yourselves up, either. (Laughter in the court.)

THE CLERK: All rise.

(The hearing in the above-entitled cause was concluded at 1:17 p.m.)

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CR NO. 99-00239 ER DEFENDANT MICHAEL H. BOULWARE'S MOTION FOR LEAVE TO PRESENT EVIDENCE OF REPORTING OF EXCESS INCOME BY HIE, OFFER OF PROOF AND REQUEST FOR FRE RULE 104 HEARING

DEFENDANT MICHAEL H. BOULWARE'S MOTION FOR LEAVE TO PRESENT EVIDENCE OF REPORTING OF EXCESS INCOME BY HIE, OFFER OF PROOF AND REQUEST FOR FRE RULE 104 HEARING

Defendant MICHAEL H. BOULWARE (hereinafter "Defendant" or "Boulware"), by and through his attorneys, Reinwald, O'Connor and Playdon LLP, respectfully moves this Honorable Court for leave to present evidence of excess income reported by Hawaiian Isles Enterprises, Inc. ("HIE") during the relevant years on the grounds that such evidence is highly relevant to disprove the elements of intent and tax evasion and false information. The evidence of HIE's reporting of excess income is also relevant to prove that the instant case is not a corporate diversion case.

Defendant Boulware also submits the instant Motion as an offer of proof as to the evidence of HIE's

reporting of excess income and its relevance to Boulware's defenses. Boulware further requests a preliminary evidentiary hearing pursuant Rule 104 of the Federal Rules of Evidence ("FRE") if the Court is not inclined to grant this Motion based on this written submission.

This motion is brought pursuant to this Court's oral ruling on June 30, 2005, FRE Rule 104 and is based upon the memorandum, declaration of counsel and exhibit attached hereto and the record and files herein.

DATED: Honolulu, Hawaii, July 5, 2005.

/s/ [Illegible]
DENNIS E. W. O'CONNOR
Attorney for Defendant
MICHAEL H. BOULWARE

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CR NO. 99-00239 ER MEMORANDUM IN SUPPORT OF MOTION HEARING DATE: TIME: JUDGE: EDWARD RAFEEDIE TRIAL DATE: JUNE 27, 2005

MEMORANDUM IN SUPPORT OF MOTION

I. INTRODUCTION

Pursuant to this Court's oral ruling on June 30, 2005, Defendant Boulware hereby moves this Court for leave to present evidence of the reporting of excess income by HIE because, for the reasons discussed more fully below, such evidence is highly relevant and integral to Defendant Boulware's defense to the charges alleged against him by the government. The government essentially alleges that this is a corporate diversion or skimming case whereby Boulware is alleged to have diverted funds intended for HIE such that HIE never reported the funds as income or obtained funds from HIE through other means for his own personal purposes.

In order to rebut the government's allegations, Defendant Boulware intends to present evidence, both from expert and non-expert witnesses, that will prove that, contrary to the government's position, all of the monies allegedly diverted by Boulware from HIE were indeed reported as income by HIE through the over-reported income. Defendant Boulware further intends to prove that all funds at issue were corporate advances or loans or were being used for corporate purposes and that Boulware always understood as much.

Boulware will also present evidence that the funds that the government claims to be unreported income had indeed been contemporaneously reported as income by HIE through the reported excess income

and that such funds were contemporaneously recognized by HIE as being assets of the corporation. For these reasons, which are discussed more fully below, Defendant Boulware submits that the evidence of HIE's reporting of excess income during the tax years at issue is highly relevant and crucial to the presentation of his defense to the tax charges in this case.

Defendant Boulware will discuss below the factual or evidentiary support for the relevance of HIE's reporting of excess income. To the extent that the factual support is not as yet in evidence, Boulware submits the stated facts as his offer of proof

Should the Court find that the stated offer of proof is not sufficient, Boulware respectfully requests a further evidentiary hearing pursuant to FRE Rule 104 to present any testimonial or documentary evidence to address any inquiry or concern of the Court.

II. FACTUAL SUPPORT

Defendant Boulware intends to present evidence through Merwyn Manago, the comptroller of HIE during the relevant years, that from 1989 through 1995, at Boulware's direction, Manago made monthly contemporaneous adjustments to HIE's books. In these monthly adjustments, Manago credited or reduced the amount of the cost of goods sold thereby causing a reporting of an excess amount of reported income taxable to HIE. Manago also contemporaneously debited the amount of the tobacco tax liability thereby causing an increase in HIE's reported net

assets. Defendant Boulware will present expert testimony that such accounting practices conformed to generally accepted accounting practice.

Defendant Boulware will present father evidence from Manago that, although he was not aware of the actual components of the monthly adjustments at the time he made them, he later learned through reclassification entries that the monthly adjustments were comprised of recapture of excess tobacco taxes previously paid, monies used by Boulware from over-the-counter sales, and income generated by Defendant Boulware's from off-book activities. Manago therefore entered adjustments in the HIE accounting journals to reflect the proper classifications of the components of the monthly adjustments. Defendant Boulware will present expert testimony that the reclassification entries done after the fact is wholly consistent with recognized and accepted accounting practices.

Defendant Boulware will present expert testimony to explain that once HIE recognized the excess or over-reported income as company assets, the monies in Boulware's hands, as the controlling shareholder of a closely held corporation, could either be non-taxable if they are considered to be corporate advances or loans or potentially taxable if they are considered to be constructive dividends or return of capital. The expert will further explain that if Boulware used the monies for corporate purposes, the monies were not income to Boulware. Alternatively, the expert will explain that if the monies were not loans or advances or if Boulware did not use the

monies for corporate purposes, then as the controlling shareholder, the monies could be deemed a constructive dividend or return of capital to Boulware which may or may not be income depending on whether or not HIE had earnings and profits for the years when the monies were obtained by Boulware.

Defendant Boulware will also present evidence that during the charged tax years, he was the president, secretary and treasurer of HIE and the controlling shareholder. Boulware will present further evidence that all of the alleged unreported income was either a loan or advance or was used by Boulware for corporate purposes or for the benefit of HIE. Boulware will present further evidence that at no time during the relevant years was Manago an officer of HIE. The evidence will therefore show that Manago's knowledge or lack thereof regarding Boulware's use of the funds for off-book transactions are not determinative as to whether HIE was aware of the off-book transactions.

The evidence will also show that Manago advised Boulware that the adjustments that Boulware directed Manago to make monthly would increase HIE's reported income. Therefore, the evidence will establish that by directing Manago to make the monthly adjustments to reflect additional income, Boulware intended that the over-the-counter sales and off-book income be reported as HIE income.

Based on the above, Boulware submits that the evidence will explain that the overstated or over-reported

income by HIE from 1989 to 1995 represented assets of HIE which, in the hands of Boulware, were either used by Boulware for corporate purposes or were corporate advances or loans and therefore were not income to Boulware. Boulware will present further evidence that goods, monies and properties that were derived from the corporate advances were returned to HIE, especially through the state court judgment. Boulware will also present evidence of that certain off-book transactions were properly booked to Boulware as officer loans and that he has repaid a substantial portion of such loans.

For these reasons, Boulware submits that the excess income reported by HIE for the years 1989 through 1995 is highly relevant and significant to his defense that the alleged unreported income was never income to him personally and that he intended to either use such monies for anything other than corporate purposes or treat them as loans or advances from HIE.

III. LEGAL SUPPORT

The reporting of excess income by HIE is relevant to Boulware's defense in two ways. First, the over-reported income establishes Boulware's lack of willfulness in that he caused the over-the-counter sales proceeds and the income from his off-book activities to be reported as income by HIE. *U.S. v. Thompson,* 23 F.3d 1225, 1228, n.4 (7th Cir. 1994) (individual's filing of personal income on corporate tax return may

show lack of intent to evade taxes) (citing *U.S. v. Gurtanca,* 836 F.2d 283 (7th Cir. 1987).

Second, the, over-reported income is evidence of Defendant Boulware's use of corporate funds for corporate purposes which renders the disputed funds as nontaxable to Boulware. In *Stone v. C.I.R.,* 865 F.2d 342 (D.C.Cir. 1989), the D.C. Court of Appeals observed that "even when a corporate officer is its sole shareholder (and thus in ultimate control), and he transfers corporate funds to his personal checking account, and his dealings with the corporation are 'extremely informal,' there is no constructive dividend so long as he can show that his intent 'was to use such funds for corporate purposes as an agent of the corporation.'" *Id.* at 343 (quoting *Nasser v. U.S.,* 257 F. Supp. 443, 449 (N.D. Cal. 1966)). In this case, it is Defendant Boulware's position that the funds that the government claims were income to him personally were instead corporate funds, as reported by HIE through the over-reported income, which he was using for corporate purposes as an agent of the corporation, HIE.

Furthermore, Defendant Boulware submits that, contrary to the government's contention, the fact that Manago, HIE's comptroller, may not have been aware of the funds or Boulware's use of the funds is not dispositive because, "[t]he knowledge of a director, officer, sole shareholder or controlling person of a corporation is imputable to that corporation." *Donovan v. Schmoutey,* 592 F. Supp. 1361, 1399 (D. Nev. 1984) (citations omitted). Therefore, Boulware's

knowledge that he was causing the over-the-counter sales and off-book income to be reported as HIE income through the monthly adjustments that he directed Manago to pick up is knowledge on the part of HIE that such income was HIE's income. In addition, Boulware's knowledge that he was using such funds for corporate purposes is imputed to HIE.

More importantly, in *Nasser* the federal district court for the Northern District of California observed that whether a distribution by a corporation to its sole stockholder is dividend income or funds transferred "to be used by him as an investment agent on behalf of the corporation for its purposes and therefore not a dividend [income]" is a question of fact. 257 F. Supp. At 447. The *Nasser* court further observed that the primary factual determination is the intention of the sole shareholder at the time the transfer is made. *Id.* In making that determination, the *Nasser* court noted that the trier of fact must consider three types of evidence: the testimony of the taxpayer himself, objective evidence which is contemporaneous with the transfer of funds, and "evidence as to the acts subsequent to the date of transfer." *Id.* Finally, the *Nasser* court noted that the trier of fact "must consider what the taxpayer did, not what he formally intended to do, nor what he declared by bookkeeping entries he had done. . . . However, the formal bookkeeping entries and ultimate disposition of the funds may be given as much weight as they deserve in the particular circumstances of the transaction in the context of a close corporation." *Id.* at 448.

In this case, the over-reported income is significant evidence that Defendant Boulware, at all times, believed that the funds at issue were HIE's corporate funds which were either loaned or advanced to him or used by him for corporate purposes and not funds transferred to him for personal use. Therefore, the over-reported income is highly relevant to Boulware's defense that he never realized personal income through the use of the funds.

DATED: Honolulu, Hawaii, July 2005.

/s/ [Illegible]
DENNIS E. W. O'CONNOR
Attorney for Defendant
MICHAEL H. BOULWARE

EDWARD H. KUBO, JR. #2499
United States Attorney
District of Hawaii

LESLIE E. OSBORNE, JR. #3740
Assistant U.S. Attorney
Room 6100, PJKK Federal Building
300 Ala Moana Blvd., Box 50183
Honolulu, Hawaii 96850
Telephone: (808) 541-2850
Facsimile: (808) 541-2958
E-mail: Les.Osborne@usdoj.gov

JARED E. DWYER
Trial Attorney
U.S. Department of Justice
Tax Division
P.O. Box 972
Washington, D.C. 20044
Telephone: (202) 514-5189
Facsimile: (202) 514-9623
Email: jared.e.dwyer@usdoj.gov

Attorneys for Plaintiff
UNITED STATES OF AMERICA

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, v. MICHAEL H. BOULWARE, Defendant.	CR. NO. 99-00239 ER MEMORANDUM IN OPPOSITION TO DEFENDANT'S MOTION FOR LEAVE TO PRESENT EVIDENCE OF REPORTING OF EXCESS INCOME BY HIE, OFFER OF PROOF AND REQUEST FOR F.R.E. 104 HEARING; CERTIFICATE OF SERVICE Trial: June 27, 2005 Judge: Edward Rafeedie

MEMORANDUM IN OPPOSITION TO DEFENDANT'S MOTION FOR LEAVE TO PRESENT EVIDENCE OF REPORTING OF EXCESS INCOME BY HIE, OFFER OF PROOF AND REQUEST FOR F.R.E. 104 HEARING

(Filed Jul. 6, 2005)

The United States of America, by and through the undersigned attorney, files this memorandum in opposition to the Defendant's Motion for Leave to Present Evidence of Excess Income by HIE, Offer of Proof and Request for F.R.E. 104 Hearing.

By way of the above-referenced motion, the defendant seeks leave of the court to present evidence relating to three separate areas: (1) the alleged over-reporting of HIE's income, *see* Def.'s Mem., pp. 1-2; (2) expert testimony regarding the reasonableness of various HIE accounting practices, *see* Def.'s Mem., p. 3, p. 4; and (3) expert testimony regarding the issue of constructive distributions and returns of capital, *see* Def.'s Mem., p. 4. For the reasons that hereinafter follow, the motion should be denied in its entirety.

1. HIE'S ALLEGED OVER-REPORTING OF INCOME:

The defendant seeks to introduce evidence regarding the fact that HIE allegedly over-reported its income during the prosecution years. Evidence of a corporation's income is irrelevant to a personal income tax prosecution. *See United States v. Miller,* 545 F.2d 1204, 1214 n.12 (9th Cir. 1976) (defendant has violated the tax evasion statute "once the taxpayer has assumed control of the funds and then fails to report such funds as income"); *see also United States v. Curtis,* 782 F.2d 593, 596 (6th Cir. 1986) (rejecting defendant's claim that he could not be convicted of tax evasion where corporation had paid taxes on the funds that he had diverted). The defendant nevertheless contends that this evidence is relevant in three ways. First, it allegedly rebuts the defendant's understanding of the government position that the corporation did not report the diverted funds at issue as income. Second, the defendant argues that this

evidence establishes "Boulware's lack of willfulness in that he caused the over-the-counter sales proceeds and the income from his off-book activities to be reported as income by HIE." Def.'s Br., p. 6. Finally, the defendant maintains that the "over-reported income is evidence of Defendant Boulware's use of corporate funds for corporate purposes which renders the disputed funds as nontaxable to Boulware." Def.'s Br., p. 6. Because the evidence of HIE's over-reporting its income is not relevant to the three areas identified by the defendant, the motion should be denied. Furthermore, the evidence should be excluded pursuant to Fed. R. Evid. 403.

Rebuttal of the Government's Case:

The defendant contends that evidence regarding HIE's alleged over-reporting of its income is relevant to rebut the government's purported position that HIE's income was under-reported during the relevant time period. Because the defendant misstates the nature of the government's evidence, this contention is incorrect. Put simply, the government has never alleged that the defendant's wrongdoing resulted in the corporation's under-reporting of income. Rather the government has maintained – indeed it is essentially undisputed – that the cash and checks resulting from various over-the-counter sales and bulk coffee sales were never reported as receipts on the corporate books because the defendant took those checks and cash for himself. In other words, the general ledger was not properly credited with the receipts of these

monies. This, however, does not mean that corporation under-reported its corporate income and the government has never maintained as much. Therefore the defendant's contention that the over-reporting of income rebuts the undisputed fact that various receipts of money were not reported on the corporate books, simply mixes apples with oranges. To contend that the two are the same would only lead to confusion of the issues and mislead the jury.

More importantly, however, whether the corporation recorded the receipts of these funds as income is ultimately irrelevant. The issue is whether the funds at issue were income to the defendant. The issue is not whether they could also be considered income of the corporation. Permitting this evidence would confuse the issues.

Willfulness:

The defendant next maintains that the over-reporting of income is relevant to the issue of willfulness. *See* Def.'s Br., p. 6. The willfulness issue in this case is whether the defendant knew that he had an obligation to report his personal income and whether he nevertheless failed to report that income. In other words, the willfulness inquiry focuses on what the defendant believed. *See United States v. Willie,* 941 F.2d 1384, 1392 (9th Cir. 1991). Whether the corporation ultimately over-reported its income is simply irrelevant to the issue of what the defendant thought and believed. Put simply, Boulware does not contend – according to the proffer in

the motion – that he will testify that he believed the corporation's reporting of the income nullified his responsibility to report the income as personal income; indeed, such a position appears contradictory to the defendant's repeated claim that the funds at issue were not income to him. Accordingly, HIE's alleged over-reporting of its income is not relevant to the issue of willfulness.[1]

Evidence of Corporate Purposes:

Finally, the defendant maintains that the "over-reported income is evidence of Defendant Boulware's use of corporate funds for corporate purposes which renders the disputed funds as nontaxable to Boulware." Def.'s Br., p. 6. According to the defendant, "it is Defendant Boulware's position that the funds that the government claims were income to him personally were instead corporate funds, as reported by HIE through the over-reported income, which he was

[1] The defendant relies on two Seventh Circuit cases for the broad proposition that evidence of an individual's reporting of personal income on a corporate return may show a lack of intent to evade taxes. *See* Def.'s Br., p. 6. Putting aside the fact that the defendant misstates those cases' holdings, both cases plainly indicate that the issue of willfulness focuses on the issue of the defendant's belief. *United States v. Thompson,* 23 F.3d 1225, 1228 n.4 (7th Cir. 1994); *United States v. Gartunca,* 836 F.2d 283, 285-86 (7th 1987). Thus, absent some showing that Boulware had a belief that the reporting of the income on the corporate books negated his duty to report the income, neither of the cases cited by the defendant make the issue of corporate income relevant.

using for corporate purposes as an agent for the corporation." Def.'s Br., p. 6. This offer of proof is similarly unpersuasive.

Whether the corporation reported the funds that are charged in this case as income is irrelevant to the issues in this case. The issue with regard to the 10 million dollars in this case is whether it was income to Michael H. Boulware. It is irrelevant whether these same funds were declared as income by the corporation. Further, the fact that the corporation had a legitimate claim to all of the funds charged as income in this case simply does not negate the fact that those funds may still be income to the defendant. *See James v. United States,* 366 U.S. 213, 219 (1961) ("When a taxpayer acquires earnings . . . without the consensual recognition . . . of an obligation to repay and without restriction as to their disposition, he has received income . . . even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.") Moreover, contrary to the defendant's contention, HIE's mere over-reporting of income does not make the funds "corporate funds" used for a corporate purpose. Accordingly, HIE's alleged over-reporting of income is irrelevant to the issue of whether the funds at issue were corporate funds.

Fed. R. Evid. 403

Even if the defendant could establish that HIE's alleged over-reporting of income had marginal probative value, the evidence should nevertheless be excluded because it is misleading, confusing and will unnecessarily lead to delay of the trial. Notably, the defendant does not intend to simply offer evidence of HIE's alleged over-reporting of income. Rather, in order to explain how the income was over-reported, the evidence will show that the accounting involved was not a simple increase in the company's income. The precise accounting involved multiple contemporaneous adjustments to the corporate books. Specifically, the books were adjusted to: falsely state the cost of goods sold of tobacco products; adjust up the excise tax payable account on the other side of the books; and also reclassify the sales of various goods. These month end adjustments – allegedly – resulted in the increase of reported income. In addition, the defendant will also, apparently, present evidence relating to subsequent reclassifications of these entries that were intended to reclassify the previous adjustments for purposes of accounting for the defendant's off-book activities.

Explanation of these adjustments will require extensive testimony and cross-examination of issues that are simply not relevant to the issues in this case. Because these issues are not relevant they will only mislead the jury, confuse the issues and ultimately lead to unnecessary delay of time. Accordingly, any marginal relevance of HIE's alleged over-reporting of

its income is substantially outweighed by these factors and should be excluded pursuant to Fed. R. Evid. 403. *See United States v. Iskander,* 407 F.3d 232, (4th Cir. 2005) (trial court properly excluded evidence and testimony relating to corporation's tax status under Fed. R. Evid. 403 in personal income tax evasion case).

2. Expert Testimony:

By way of the instant motion, the defendant also seeks to offer expert testimony regarding the propriety of the accounting entries that resulted in HIE's alleged over-reporting of income. Def.'s Br. p. 2, p. 3, p. 4. Whether HIE over-reported its income is a fact questions it is not a question requiring specialized or technical training. Moreover, to the extent that expert evidence is being offered to show the propriety of the accounting practices of HIE, it should not be allowed because it is irrelevant.[2] Whether the HIE's actions were reasonable is not relevant. Accordingly, the motion should be denied insofar as it seeks leave to

[2] This court has previously ruled that the defendant is not permitted to introduce expert evidence relating to the what the law is or whether the law is confusing. *United States v. Scholl,* 166 F.3d 964, 972-73 (9th Cir. 1999) ("The reasonableness of [the defendant's belief] is irrelevant; the only relevant issue is whether [the defendant] actually had this belief."). Expert testimony relating to the propriety of HIE's accounting practices should be similarly excluded. Not only is irrelevant it is simply offered to bolster the credibility of fact witnesses.

offer expert testimony regarding HIE's alleged over-reported income and the propriety of HIE's accounting practices.

3. Corporate Distributions, Constructive Dividends and Returns of Capital:

Although not explicitly stated in the motion caption, the defendant also seeks to offer "expert testimony to explain that . . . the [diverted] monies in Boulware's hands, as the controlling shareholder of a closely held corporation, *could* either be non-taxable of they are considered to be corporate advances or loans or potentially taxable if they are considered to be constructive dividends." Def.'s Br., p. 4 (emphasis added). This court has already excluded evidence of this type when it granted the United States' motion *in limine* regarding the applicable law and United States' motion *in limine* regarding corporate distributions and returns of capital. The defendant has failed to articulate any reason why those rulings should be revisited.

First, with regard to the defendant's intention to offer expert testimony regarding the possible tax consequences of the defendant's receipt of funds at issue in this case, that is an issue of law. To permit expert testimony in this regard would usurp the court's authority and lead to unnecessary confusion of the issues. *Cooley v. United States,* 501 F.2d 1249, 1253-54 (9th Cir. 1974) ("the law is given by the court and not introduced as evidence"); *accord United*

States v. Willie, 941 F.2d 1384, 1396 (10th Cir. 1991), *cert. denied,* 502 U.S. 1106 (1992). Accordingly, the defendant should not be permitted to offer expert testimony explaining what types of money transfers are taxable.

Similarly, this court has already concluded that the defendant may not present any testimony, argument or evidence relating to the issues of constructive distributions or returns of capital without laying the necessary foundation. *See United States v. Miller,* 545 F.2d 1204, 1214 (9th Cir. 1976) ("there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be [a return of capital]"). The defendant's motion does not contain any such proffer. Rather, it simply seeks to offer expert testimony regarding how the funds at issue "could" be characterized. Therefore, to the extent that the defendant seeks to offer testimony regarding how the funds at issue could be characterized and the accompanying tax effect – such evidence should be excluded based on the court's prior ruling and the defendant's failure to lay the necessary foundation.

Conclusion:

For all of the reasons expressed herein, the United States respectfully requests that the Defendant's Motion for Leave to Present Evidence of Excess Income by HIE, Offer of Proof and Request for F.R.E. 104 Hearing be denied.

DATED: July 6, 2005 at Honolulu, Hawaii.

Respectfully submitted,

EDWARD H. KUBO, JR.
United States Attorney
District of Hawaii

By /s/ Leslie E. Osborne, Jr.
LESLIE E. OSBORNE, JR.
Assistant United States Attorney

JARED E. DWYER
Trial Attorney
U.S. Department of Justice
Tax Division

Attorneys for Plaintiff
UNITED STATES OF AMERICA

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	CRIMINAL NO. 99-00239ER
vs.	)	
MICHAEL H. BOULWARE,	)	– VOLUME 8 –
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Monday, July 11, 2005, at 9:07 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
DENNIS E.W. O'CONNOR, JR., ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[24] commercial litigation.

Q. In your experience, is it common practice to value businesses in marital disputes?

A. Where the attorneys for the parties deem it significant, yes, it is often the case.

Q. In this particular case, we have asked you to value some businesses, have we not?

A. That's correct.

Q. And the businesses that we have asked you to value are the Hawaiian Isles Enterprises water company –

First, is that correct? Is that one of them?

A. Yes, it is. More specifically, I was asked to value a 100 percent ownership interest in Royal Hawaiian Water Company.

Q. Yes.

A. Which later became a subsidiary of – or an affiliate of Hawaiian Isles Enterprises.

Q. Is that company also known as Hawaiian Isles Water Company?

A. (Perusing documents.)

Yes, sir. It does business under that trade name.

Q. What steps did you take in order to value that company?

First of all, were you given a specific date to value that?

A. I was actually requested to value that company as of two [25] dates. The first being June 30th, 1997; and the second being June 30th, 1998.

Q. Do you know why you were given two dates?

A. I don't know. I was engaged by the CPA firm for the company, and I understood it was for corporate and tax planning.

Q. Okay.

A. But I don't know why there were two specific dates.

Q. And the CPA firm is the Kobayashi Doi and Lum firm?

A. That's correct.

Q. What did you do in order to value Hawaiian Isles Water?

A. Well, I did what I would do in any circumstance like this, where we had this assignment.

And that's to gain an understanding of the business that we have been hired to value. That is, to understand its resources, in other words, you know, its workforce, its historical financial statements, its – to do a survey of competition, the economy in which it operated, the industry in which it operated.

All towards the end of understanding what an investor would be willing to pay to own, in this particular circumstance, a 100 percent ownership interest.

Q. What was the business of Hawaiian Isles Water Company?

A. (Perusing documents.)

They distributed bottled water products in Hawaii, [26] and they have done so since 1996.

Q. So what did you do in order to value the company?

A. (Perusing documents.)

Well, we studied its historical operating results, interviewed the controller, interviewed their CPA who had been serving that company for – since its creation.

I analyzed its ability to pay distributions.

I looked for similar – I looked at transactions involving similar businesses.

I should explain, just briefly, that there are three general approaches to valuing a business.

One of them is commonly used for valuing residential property. It's called market approach, in that circumstance. The other two are the income approach and the asset-based approach.

In the income approach, we work to understand the ability of the company to distribute income to an owner.

And in the third approach, which I mentioned earlier, the asset-based approach, we looked to understand the value of the assets that a company may own.

That last approach is more appropriate for companies that just own real estate or just own marketable securities.

It can be used to value growing concerns, but it's not my preferred method of doing so.

In this circumstance, I found that the most [27] appropriate method was the market approach.

Because I found that there was a company called Hawaiian Natural Water that had actually gone public; in other words, it had issued stocks on the public market, in May of 1997. And up through the – it had been trading stocks subsequent to that event.

So I studied Hawaii Natural Water, because it had a similar marketplace, similar product: Water from Hawaii.

And based on its – (perusing documents) – ratio of price per share, market capitalization, divided by annual sales, derived a factor for valuing the subject, Hawaiian Isles Water.

Q. How did you – did you value this as an ongoing business?

A. Oh, certainly. It was a going concern. There was no question about that.

Q. And specifically what did you fix the value of the company at?

A. (Perusing documents.)

I determined that the fair market value of the 100 percent interest in the company at June 30, 1997 was $1,572,000.

With respect to the June 30th, 1998 date, I determined that the fair market value of the similar interest was $1,722,000.

Now, I should mention that, in addition to accepting [28] the assignment to determine the fair market value of the business, I was also asked by Mr. Kobayashi, of the CPA firm, to determine the investment value of the businesses to Hawaiian Island Enterprises.

I should explain what the difference is between fair market value –

Q. Please do.

A. – and investment value.

Fair market value is generally described as the price for a particular property that a willing buyer would pay and a willing seller would accept, where both are reasonably informed about the relevant information and neither party's acting under duress.

So that's what fair market value is.

Investment value is the value to a particular party.

For instance, the values that you'll see traded on the public stock exchanges, New York Stock Exchange, the American Stock Exchange, and the Nasdaq, is the fair market value that investors would pay to own a share or 100 shares in a particular company.

Often, if you have the time to read the financial pages, you'll see that public companies will buy each other, or sometimes venture capitalists will buy another company for a price in excess, higher than what's normally traded on the marketplace.

[29] For instance, a stock in the company might be at $27, for example. And another company who wants to acquire it will offer $30 or $32.

That's because, in the eye of the beholder, the buyer, will see that it's worth more for them to control this other company, they perceive perhaps savings in expenses, they will only need one chief executive

instead of two, they will only need one controller rather than two, that type of thing.

So the investment value to that acquiring company is higher than the fair market value might be.

And in this circumstance, I was asked to estimate the investment value to Hawaiian Isles Enterprises.

I did that –

Q. Did you do that on two dates, also?

A. I did that on two dates.

Q. And what are the two dates, again?

A. The two dates are June 30th, 1997 –

Q. And what was the investment value on that date of the company?

A. $1,826,000.

Q. And the other date was what date?

A. The other valuation date was June 30th, 1998.

Q. What was the value of the water company on that date?

A. $2,182,000.

Q. Did you put all of this information into a report?

[30] A. Yes, I did, sir.

Q. Is that report Defendant's Exhibit 1665?

A. I have not reviewed the exhibit, sir.

Q. Do you have a booklet there before you –

A. Oh, I'm sorry, yeah.

Defendant's Exhibit 1665?

Q. Yeah.

Turn, if you would, to 1665.

A. (Perusing documents.)

Q. Is that your report?

A. Yes, sir, it is.

MR. O'CONNOR: Your Honor, at this time we offer Exhibit 1665 in evidence.

THE COURT: Any objection?

MR. O'CONNOR: No objection.

THE COURT: Very well. It may be admitted.

(Exhibit 1665 received in evidence.)

BY MR. O'CONNOR:

Q. In addition to valuing the Hawaiian Isles Water Company, were you asked also to value the coffee-processing and wholesaling business which had been established by Mr. Boulware?

A. That is correct.

I was asked to estimate the fair market value of that business as of July 1, 1992.

[31] In addition, similar to the other assignment, I was also asked to estimate the investment value.

Q. All right.

Who asked you to do that?

A. Again, it was Mr. Kobayashi, of the Kobayashi Doi & Lum CPA firm.

Q. As you sit there, I take it you don't know why they asked you?

A. I understood it was in connection with corporate and tax-planning purposes.

This is not unusual for me to accept an assignment of this kind.

THE COURT: Well, you've answered the question.

BY MR. O'CONNOR:

Q. What steps did you take in –

What is this business? What business were you valuing?

A. (Perusing documents.)

This is a business in which coffee beans were purchased from coffee farmers, processed into coffee grounds, fine or coarse, and marketed, in Hawaii and elsewhere.

Typically it was Kona coffee.

THE COURT: Well, and your report identified this as valuation of a 100 percent interest in Mr. Michael Boulware's coffee-processing and wholesaling business?

[32] THE WITNESS: Yes, Your Honor.

THE COURT: All right.

That is what you evaluated?

THE WITNESS: That's correct, Your Honor.

BY MR. O'CONNOR:

Q. What steps did you take in order to value that business?

A. (Perusing documents.)

Well, similar to the other business, I familiarized myself with the business' operations, its resources, the economy and industry in which it operated.

You may recall that I explained that there were three generally used approaches to valuing a business

In this circumstance, I could not locate transactions involving similar businesses. So I relied on –

And the asset-based approach was not useful, because of the going concern nature of this business.

So I relied on – or used the income approach.

And in doing so, I studied the company's revenues and expenses – (perusing documents) – and – (perusing documents) – made some estimates as to what its expenses would be if it were not relying on warehousing and other help from other companies that Mr. Boulware owned at the time – I think there were conservative estimates of additional expenses that a buyer would have had to incur to operate the businesses – and determined what the, going forward, free cash-flows [33] from the business would be.

I determined those businesses would generate about $330,000 – or this business would generate about $330,000, on an average, going forward.

I determined that an investor would require close to 16 percent annual return. Which is a very high return. Because there is a certain amount of risk in a small business.

I considered that this would be a 100 percent interest, rather than a fractional interest, and that of a small premium for control involved in that, arriving at a preliminary figure of $2,310,000.

I then took a very dramatic discount in that value, in order to recognize that this was a small business that was not traded on the New York Stock Exchange or on any other stock exchange.

I discounted the preliminary indication by 20 percent. To arrive at a fair market value conclusion, as of the valuation date, of $1,850,000.

Q. Did you make a conclusion regarding the investment value?

A. Yes, sir, I did.

And in doing that, I studied the annual savings that Hawaiian Island Enterprises would have enjoyed by merging the two companies.

I estimated that the value to Hawaiian Island Enterprises, over and above the fair market value, was [34] $960,000.

This resulted in a conclusion of investment value to Hawaiian Island Enterprises of $2,800,000 for this business, as of July 1, 1992.

Q. And did you render a report setting out what you've done, and that value?

A. That's correct.

I wrote a report documenting my – summarizing my work and documenting my conclusions, and –

Q. I ask you to turn to Defendant's Exhibit 1668, which is in the book before you.

A. (Perusing documents.)

Yes, I have that before me.

And – (perusing documents) – this is –

Q. Is that the report?

A. This is my report.

Q. And that sets out the investment value of this coffee business; is that right?

A. That's correct.

MR. O'CONNOR: Your Honor, we offer Exhibit 1668 in evidence.

MR. O'CONNOR: No objection.

THE COURT: It may be admitted.

(Exhibit 1668 received in evidence.)

MR. O'CONNOR: I have no further questions.

[35] Thank you.

THE COURT: You may cross-examine the witness.

MR. OSBORNE: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. OSBORNE:

Q. Sir, you found the water company to be a sole proprietorship, right?

A. I believe that's so.

Q. Okay.

I was asking you, because at Page 15 of 1665 – I think it's Page 15; I might have gotten a little off

there – (perusing documents) – I believe you referred to stock in the company.

But there was no stock, was there?

A. I don't recall that there was stock.

I'm having trouble finding the reference you're referring to.

Q. Okay.

But it was, to the best of your knowledge, a sole proprietorship?

A. To the best of my recollection.

Q. Okay.

Did you determine where the monies came from to invest in the water company?

A. No.

[36] Q. And who did you understand the sole proprietor was?

A. I understood it was Mr. Boulware.

Q. Was that a profitable company? Did it make a profit at any time during its history? Before he turned it over to Hawaiian Isles.

A. (Perusing documents.)

No, sir. Based on my analysis, it did not make money.

Q. Okay.

Now, I assume, sir, you are also acquainted with personal income tax returns. Is that correct?

A. Yes, I am.

Q. And, as a sole proprietorship during the years in question, Mr. Boulware would have been required to file a Schedule C, wouldn't he? On his personal return?

A. I imagine that's so.

Q. Did you check to see if he filed a Schedule C?

A. I don't recall that I did.

Q. And what's the purpose of the Schedule C?

A. I use the Schedule C to record income from my sole proprietorship.

Q. Okay.

Now, how about the coffee company? Was that also a sole proprietorship?

A. To the best of my recollection, yes.

[37] Q. And, again, you don't know where Mr. Boulware obtained the money to start that company, do you?

A. That's correct.

Q. And, again, if it was a sole proprietorship, there should have been a Schedule C, shouldn't there?

A. I haven't studied that in this circumstance –

THE COURT: Well, sir, you are a CPA, aren't you?

THE WITNESS: I am.

THE COURT: And you're not able to answer that question?

THE WITNESS: I can answer it based on my general knowledge of tax returns and tax reporting and say –

THE COURT: Well, as a person that operates a business is required to report the profit or gain or loss from the business on his individual income tax return; is that not true?

THE WITNESS: If he owns it as a sole proprietor, yes.

THE COURT: If you don't what?

THE WITNESS: If an individual owns a business or an enterprise as a sole proprietor, then yes, they would report it on Schedule C.

BY MR. OSBORNE:

Q. Okay.

And you know this was a sole proprietorship?

* * *

[89] Q. What are they?

A. As I indicated, the first – two, four, six – seven columns would look identical to the annual schedules that I prepared for officer loans, loans to stockholder.

THE COURT: Well, are there stockholders in this company?

THE WITNESS: There are – not to whom loans are made, no.

THE COURT: Well, it says schedule of loans to stockholder on the record – on the schedule there.

THE WITNESS: Yes.

THE COURT: Stockholder?

THE WITNESS: Yes.

THE COURT: What is meant by that?

THE WITNESS: Pretty much loans that were made to Mr. Boulware.

BY MR. O'CONNOR:

Q. There are other stockholders in the company, are there not? For example –

A. Yeah.

Q. – Sydney Boulware owns stock in the company?

A. No.

Q. Today he does not?

A. No.

Q. Has he been a stockholder?

[90] A. There was a time that he had stock, to my knowledge. But I think as a result of the civil litigation, if I'm not – if I remember correctly, it was invalidated.

Q. All right.

There is stock being held in a trust in this company, is there not?

A. Yes.

Q. And what is that trust?

A. The Glenn Boulware trust.

Q. And is the Glenn Boulware trust a stockholder of the company?

A. Yes. A 50 – I think it was a 50 – they are a 50 percent owner.

Q. And Mr. Mike Boulware owns stock in the company; is that not correct?

A. Yes.

Q. He is a 50 percent owner?

A. Yes.

Q. Let's look at Exhibit 1595.

A. (Perusing documents.)

Q. Do you see that?

A. Yes.

Q. Looking at that page and the pages that follow it in Exhibit 1595, what is that?

A. These are the schedule that I maintained for the loans to

* * *

[111] Enterprises?

MR. OSBORNE: Objection –

THE COURT: The objection is sustained.

MR. OSBORNE: – relevance.

THE COURT: This is going to be the subject of the ruling, and you know that it's subject to a motion.

So you shouldn't be asking about it until the court has ruled.

MR. O'CONNOR: All right.

THE COURT: We'll take our noon recess at this time. I'll ask the jury to return at 1:00. You may be excused.

THE CLERK: All rise for the jurors.

(The jury was excused at 12:04 p.m.)

(The following proceedings were held in open court, outside the presence of the jury:)

THE COURT: Now, the defendant has filed a motion for leave to present evidence of Hawaiian Isles Enterprises' alleged over-reporting of income, and an offer of proof relating to the issue of constructive dividends.

I think it would be helpful for you to understand the court's position on this, to guide what you can or cannot do in this case.

First, the court will address the motion for leave to present evidence of Hawaiian Island Enterprises' alleged [112] over-reporting of income.

The defendant offers at least two reasons why he believes this evidence should be admitted:

First, the defendant alleges that the allegedly over-reported income is relevant to his lack of willfulness.

Essentially, it appears that the defendant is arguing that he lacked a willful intent to underreport his income because he allowed it to be reported by the corporation instead of on his own returns.

While this could be relevant to the issue of willfulness, the defense has not established any foundation for this evidence, by, for example, presenting evidence that the defendant believed that if his income was reported on his corporate return, he did

not report it on his – he need not report it on his individual return.

Until and unless such a foundation is laid, the court believes that any evidence of over-reporting of income by Hawaiian Island Enterprises must be excluded as irrelevant, prejudicial and confusing to the jury.

Now, the defendant also argues that the alleged over-reporting of income is relevant because the funds at issue were in fact corporate funds being used for a corporate purpose.

Even if the defendant had laid a foundation which established that the funds at issue were corporate funds being [113] used for a corporate purpose, the defendant still has not explained why it is relevant that Hawaiian Island Enterprises over-reported those funds.

In other words, if the defendant plans to offer a defense that the funds were not income to him because he was using them for corporate purposes, it is not relevant to whether or not the corporation over-reported, under-reported, or failed to report those funds.

All that is relevant to that defense is that the funds were never income to Mr. Boulware because they could be used only for corporate purposes.

Defendant goes on to argue that he did not report the funds because he believed the funds were corporate funds being used for corporate purposes.

This argument simply appears to repeat the same argument that the defendant already made relating to his lack of willfulness, which this court has already addressed.

Now, as the court has already explained, if the defendant plans to argue that he did not believe that he was required to report the funds because they had been – already been reported by the corporation, he must lay a proper foundation, by, for example, testifying that he believed just that.

In the absence of such a foundation, the evidence is prejudicial and confusing to the jury, as well as irrelevant.

[114] Accordingly, the court, without further foundation, will deny the HIE's motion for leave to present evidence of over-reporting of income.

That's subject to reconsideration if a foundation is laid.

The court will now address to the defendant's offer of proof relating to the issue of constructive dividends and returns of capital. Which suffers from the same lack of foundation.

As the court previously explained, the Miller decision, that states that it is not relevant whether the funds could have been classified as a return of capital or a dividend at the time when they were diverted.

There is a violation, even where the diverted funds could have qualified as a return of capital, when the taxpayer fails to properly report the money as income or record it as a return of capital on the corporate books.

That's found at Page 1214 of that decision, 545 F.2d, 1204.

The defendant's offer of proof merely indicates that the defendant would introduce expert testimony that the funds at issue could have been considered return of capital.

Not only would much of this evidence be excludable as expert legal opinion, it is plainly insufficient under the Miller case.

[115] The defendant must not show merely that the funds could have been a return of capital; he must introduce evidence showing that, at the time of the transfer, the funds were in fact a return of capital.

Based upon the defendant's offer of proof, the court cannot see any benefit in holding any additional hearing on this matter.

The offer of proof fails to satisfy the standard established in the Miller case. In fact, it is expressly contrary to that standard.

And the government's motion in limine to exclude evidence relating to constructive dividends or returns of capital is hereby granted.

Now, this may very well apply to this Hawaii tax adjustment, as well.

But did you wish to be heard on any other issue?

MR. O'CONNOR: Just to clarify, Your Honor.

THE COURT: Yeah?

MR. O'CONNOR: As I understand it, the court is ruling on the over-payment of taxes by the company. Is that correct?

THE COURT: That's right.

MR. O'CONNOR: The court –

THE COURT: Because you filed a motion offering evidence of over-payment –

[116] MR. O'CONNOR: Over-payment.

THE COURT: – of income, and an offer of proof relating to the issue of constructive dividends.

MR. O'CONNOR: A little while ago –

THE COURT: I am ruling on your motion and denying it.

MR. O'CONNOR: Yes, Your Honor.

The question is –

THE COURT: I shouldn't have to explain it.

MR. O'CONNOR: The question is: Can we put on evidence of payment of taxes –

THE COURT: No.

MR. O'CONNOR: – by HIE?

Not over-payment. But the fact that they paid taxes on –

THE COURT: How is that any different than the over-reporting of taxes?

But why is it relevant? It's two different taxpayers. Your client is an individual taxpayer; the corporation is a separate taxpayer.

MR. O'CONNOR: Well, its relevant –

THE COURT: One ordinarily does not affect the other, unless there's a foundation laid to show that it should.

MR. O'CONNOR: We already have testimony in this [117] case from the accountant for the company that taxes were paid by the company. The taxes on this over-the-counter stuff and so forth, that taxes were paid by the company.

THE COURT: What's missing is the relationship to the issue of willfulness of this information. That is, no evidence that the defendant had knowledge of this, that it was a contemporaneous reaction and not contrived after the fact.

Which many of these things appear to be, contrived after the fact, to fit the case.

And that's what's missing.

MR. O'CONNOR: That's why it's important that this witness be allowed to testify about these entries that he made.

Because the entries that he made demonstrating that the company paid taxes on this –

THE COURT: Well, then, you have misunderstood the court's ruling.

This witness will not be allowed to testify and any subject . discussed. Which is –

MR. O'CONNOR: How about –

THE COURT: – which is the subject of your motion.

MR. O'CONNOR: He made these entries in 1989. Which was years before the IRS started any investigation or anything of that nature.

And therefore, the entries, although the court may [118] be correct in saying that they should not be admitted for over-payment, but the fact that the entries were made in 1989, and the fact that they reflected payment of taxes on the material that we're talking about, we should certainly be allowed to put that in on willfulness.

THE COURT: Do you wish to be heard on that?

MR. DWYER: Your Honor, I think your ruling was, without the foundation, we don't get to this for purposes of willfulness.

And I think – I don't understand why this witness should be asked about something without the necessary foundation.

THE COURT: Well, that's correct. I think the witness is covered by this, as well. There should be no evidence of that without the proper foundation that I mentioned.

Anything else?

MR. O'CONNOR: Yeah. The testimony will be, Your Honor, that the defendant, Michael Boulware, told the witness to –

THE COURT: Well, that testimony would not be admissible. What the defendant told somebody else is not admissible. Clearly hearsay in every criminal case.

There has not been as much objection here as there should be about what Mr. Boulware said. That's clearly [119] hearsay.

MR. O'CONNOR: It does go to willfulness.

THE COURT: All right.

We will reconvene at 1:00.

THE CLERK: All rise.

This court will be in recess until 1:00 p.m. (The lunch recess was taken at 12:15 p.m.)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff,	) CRIMINAL NO. 99-00239ER
vs.	)
MICHAEL H. BOULWARE, Defendant.	) - VOLUME 9 -

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Tuesday, July 12, 2005, at 9:13 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
DENNIS E.W. O'CONNOR, JR., ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[126] A. When I bought greens?

Q. Green beans in Kona.

A. That would go directly to the company.

Q. Okay.

Getting back to the use of cash.

How much were you spending, say on a yearly basis, in cash in Kona to buy coffee in those days, '90, '91, '92?

A. It's hard to say. Maybe a little slower, maybe a little higher. Maybe about a little over $2 million.

Q. A year?

A. No. I don't think so.

Q. How much a year?

A. Maybe $600,000, average.

Q. So for that total period of time, you're looking at about 2 million bucks?

A. Yes.

Q. In that time frame, who was buying coffee for Hawaiian Isles in Kona, say from '90 to '94?

A. That was Kona Sunrise Farms. Sheila. And Marvin.

Q. When you bought through her, did you pay in cash?

A. I think some. Some. But she was the bigger ones.

Q. But, primarily, how did you pay her for the coffee?

A. Checks that I got loans from the company or I borrowed from my ex-wife.

Q. You told us about Marvin Fukumitsu.

[127] A. Yes.

Q. Did you buy through him?

A. Yeah. He was doing the buying up there.

Q. And how about you?

A. Only initially.

Q. Okay.

When you went to buy, you were doing it in cash?

A. Well, yeah.

Q. And Fukumitsu, what was he using?

A. Cash.

Q. And did there come a time when you didn't have to pay cash anymore? To the farmers.

A. Yeah.

Q. What happened?

A. Well . . . When was that? I think was '94? '93?

The police, I think, wanted – the police wanted all the processors to stop paying cash.

Q. What police?

A. The police in Kona.

Because there was too much drugs. So they were stealing the parchments, the greens, the cherries. So they stopped that.

Q. So what did the police do about the cash payments?

A. They asked the processors to stop paying in cash.

Q. And did you stop paying in cash?

[128] A. Yes.

Q. By that time, had you developed a reputation in Kona for buying coffee?

A. Yes.

Q. And what did you believe your reputation to be?

A. That we kind of held up the whole Kona industry. Because when we first went in, coffee was going for about 75 cents a pound, cherry. And when we got through, it was at about $1.00, $1.25, $1.50.

Q. And you're still buying up there, are you not?

A. Yes.

Q. And what today is the price of coffee in Kona?

A. This year has been a bad year. It was in low demand.

So even as of last month, we were buying cherries – not cherries – actually green beans, because we were running short, at $13 a pound. It usually would cost us $6.

So cherry's probably going for, like, $2 a pound now.

Q. As compared to what when you started?

A. 90 cents, a dollar, 85 cents.

Q. Changing the subject for a minute to water.

Did there come a time when you decided that you were going to try to enlarge into the production and selling of water?

A. Yes.

[129] Q. And what did you do?

A. Well, I presented the whole thing to the company, about this water business.

And my brother, Merwyn, and his – (incomprehensible) – they thought I was crazy, you know, bottling water.

So they kind of fought me all the way. I tell, you know what, I'll do it on my own; I'll do this on my own and show you guys, then see where we go from there.

Q. And when you say do it on your own, what does that mean?

A. I took officer loans from the corporation, you know, bought all the equipment, started the whole thing up.

I think the loans were about $1.2 million.

Q. Did you establish a plant?

A. Yeah. We built the plant, everything.

Q. Where is your water plant?

A. Its in Mapunapuna, about two blocks away from where the home office is.

Q. And, generally tell – well, specifically, what did you do first in order to get the water business going?

A. Borrowed money.

Q. And then what?

A. Then went through the whole building process, head up the marketing and all that, getting this thing off the ground.

Q. Were there employees hired for the water company?

[130] A. Yes.

Q. Who hired them?

A. I did.

Q. And what did those employees do at the water company?

A. We did two things. We did those five-gallon bottled water. Then we started in the retail market.

Q. And did you market the water throughout Honolulu?

A. Yes.

Q. In what stores today in Honolulu is your water sold?

A. Every store.

Q. What do you mean by that?

A. Well, every store except 7-Eleven.

Q. Every grocery store?

A. Grocery. Lot of golf courses. We do private labels.

Q. Do you sell water through the commissary?

A. Yes.

Q. What products does Hawaiian Isles sell through the commissary system besides the water?

A. Coffee.

Q. Anything else?

A. I got some vending machines in the military.

Q. Okay.

Has the water company been successful?

A. Well, the first two years, no. I think I lost maybe about $600,000.

[131] Q. Uh-huh.

A. But then, from then on, it's been successful.

Q. Today is it successful?

A. Yes.

Q. What has happened to the water company? What did you do with it?

A. I gave it back to the corporation.

Q. And when you gave it back to the corporation, what – were you paid for it by the corporation?

A. No.

Q. When you gave it back, did you still owe money to the corporation, officer loans, for having established it?

A. Yeah.

Q. What has happened to those loans?

A. Well, the loans are still existing, the $1.2 million. And I had to borrow the $600,000 I lost. So actually, $1.8 million, I think.

And then they did something, told me, okay, you get 30 percent more stocks or something.

Q. Okay.

Did there come a time when you sold the coffee distribution – or the coffee-buying company back to Hawaiian Isles?

A. Sold it?

Q. Or gave it back.

[132] A. Yeah.

Q. And how did that happen? What happened?

A. You know, this coffee thing is really complicated to explain, but –

But so that whole segment, I told the company, you guys go do 'em already, you know, let's get staff and all that. And so they were going to just take off.

But that one, they bought all the equipment.

Q. Who is "they"?

A. The company.

Q. From you?

A. No. I never owned the equipment.

Q. Who owned the equipment?

A. No. I never owned the equipment.

Q. Who owned the equipment?

A. The company.

Q. Who did the company buy it from?

A. You know, that same – in Brazil.

Q. Okay.

And what happened when there was a –

Was there any kind of a transfer to the company of any part of the coffee – the company?

A. Yeah. I transferred that whole operation, who to contact, who to do what.

But what really happened was I bought some land in

[133] Kona –

Q. Yes?

A. – and that's where all this processing plans was going to take place and everything.

And we planted like five acres of coffee trees – or I did – five acres of coffee trees and everything.

Then I found one heiau, you know, on the land.

Q. And what happened when you found the heiau?

A. I told the guy I bought the land from you got to take this thing back. I mean I did what I was supposed to do, blessed it, and got out.

So from that time on, the company right now just has to pick up a parcel in Kona, and all the equipment is still sitting in the Kona warehouse.

Q. Did the man you bought the land from give the – did you give the money to him?

A. Yes.

Q. Okay.

Did there come a time when HIE, Hawaiian Isles Enterprises, went into any other business besides the two that we just were talking about?

A. You mean new businesses?

Q. New businesses.

Did you try any new businesses?

A. No. Not that I can recall.

* * *

[240] commissioner on the statutory notice of deficiency.

Q. What does the $8,725 –

A. Well, that's $8 million –

Q. $8 million. I beg your pardon.

What does that represent?

A. That is the commissioner's position addressed to the so-called criminal omitted income.

The government is proposing that, in the criminal – this criminal case, that Mr. Boulware failed to report $10.2 million – or $10,215,000 – of income.

The commissioner took the position that the $1,195,000 and the $295,000, Automated Equipment and Bonded Construction amounts, should not have been taxed to Mr. Boulware; and that therefore, the remaining amount only of $8,725,000 should be the amount taxed to Mr. Boulware.

Q. All right.

Moving on. Your next item states, additional deductions by the government per indictment.

What does that mean?

A. That was simply – these were amounts simply picked up off of the indictment.

Page 2 of the computations of the government's indictment, which permitted Mr. Boulware deductions in 1993, for the cost of sale of coffee to Pele Trading and Misuzu, $359,000.

[241] The government also allowed Mr. Boulware deduction for the cost of paving – or improving the

Mokumoa Street parking lot, and the $30,000 reimbursements, or the paying of expenses of Mr. Briggs, as Mr. Briggs earlier testified.

Q. The next item reads, revised amount of monies delivered to Mr. Boulware per the government.

What does that mean?

A. Well, that's simply taking the $8,725,000 – this is the statutory notice – and further reducing it by these three items that I just described as allowance by the government in this case of deductions to Mr. Boulware.

Q. Now, your next item is, additional deductions claimed by the defendant.

Where does this information come from?

A. Well, there are two amounts there. Let me start with the top two amounts and generally describe it and give you further details.

These amounts represent the so-called unreported income for the year 1993.

In other words, the corporation was thought to have – or accused of having realized taxable income, meaning over-the-counter sales and coffee sales.

And the point raised by the government is that these amounts were not included as taxable income to either the corporation or Mr. Boulware.

[242] In fact, the corporation charged Mr. Boulware with the share of the alleged income, $765,000, for that period, 1993, and charged Ms. Lee shareholder loans of $999,600, or a million dollars.

Again, the theory that is applicable here is that, if these amounts are charged to officer loans, they cannot be charged simultaneously as income. They are either one or the other.

Since they were charged as –

MR. DWYER: Objection, Your Honor. The defendant is arguing law – or, the witness is arguing law at this point.

THE COURT: That's correct.

And that is not permitted, by the order of the court.

BY MR. O'CONNOR:

Q. Directing your attention to these particular entries, $765,000 and $1 million. Where did they come from?

A. They come from the books and records of Hawaiian Isles Enterprises.

Q. Were they put in evidence in this case?

A. Well, they were charged by use of adjusting journal entries, which are in evidence in this case.

Q. All right.

Moving on. There is an item, cost of coffee sold to Pele Trading and Hawaii Misuzu. Where does that come from?

[243] A. That's a figure that is calculated.

In other words, Mr. Tsukamoto of Price Waterhouse earlier testified that they did an analysis of the cost of coffee that was sold, and they arrived at the conclusion that the cost of goods sold equalled 93 percent of the selling prices.

In this particular case, the company had claimed cost of goods sold by a similar method. It, however, claimed 75 percent of the sales price as cost of goods sold.

Therefore, reflecting a 25 percent profit margin, rather than the seven percent profit margin that Mr. Tsukamoto earlier testified to.

Remember, he testified that the cost of goods sold should be 93 percent; therefore, the profits, or gross profits, should be seven percent.

In this case, the company used 25 percent as the profits.

Now, this has to be added to the earlier amount above, wherein the government allowed Mr. Boulware I believe it was $359,000 cost of goods sold for the year 1993.

And therefore –

Or $359,000; I'm sorry.

And therefore, when you add these two amounts, you will arrive at approximately $2,025,000, or thereabouts, as the total cost of goods sold for these years in question, [244] meaning '89 through '93.

Q. Turning to Page 2 of your exhibit.

A. Well, I'd like to finish up on Page 1, sir. Back to Page 1?

Q. The top of Page 2 is the same as the bottom of Page 1, is it not?

A. Yes.

And now, the $4,872,000 represents the net difference between the taxpayer, or defendant, and the government. The government's position is that $10,215,000 is taxable.

After these adjustments that I have now discussed, there was the taxpayer's contention that the amount in dispute, that could be taxable but which the defendant claims is not taxable because they are advances, but whichever the argument is, the amount in dispute is $4,872,000, for the reasons that I have described earlier.

Q. Now I direct your attention to the entry which says, properties returned by Mr. Boulware.

Why is that entry on this page?

A. Well, this is now another phase of this analysis.

And assuming that these amounts are either advances or potential taxable income, these amounts that total $6,827,000 represent properties returned to HIE.

And if they are potentially taxable, the return of [245] these properties negate the taxability, because the total amounts returned equal approximately – or excessive amounts returned – I'm sorry – equal $1,955,000.

Q. The first entry is Koloa real estate.

What does that refer to?

A. That is a piece of property that has been under discussion. That's the cost of Koloa.

That was ultimately delivered by Mr. Boulware to HIE.

Q. The second, green Kona coffee beans.

A. These were beans that were delivered by Mr. Boulware directly to HIE during the years '89 through approximately 1992.

Q. The next entry is, cost to start water company. What does that refer to?

A. That was earlier discussed as the amount that Mr. Boulware was charged as officer loans by HIE while he was in the process of starting the water company.

He was charged officer loans until such time that, of course, the water company was returned. In fact –

Or, I shouldn't say returned. It was delivered to HIE. In fact, that was done. However, the $1,205,000 was never forgiven by HIE.

So Mr. Boulware continued to owe that amount; and of course paid down these amounts as part of the pay-downs of the [246] officer loans, to arrive at the balance that was earlier testified to, of approximately $1.6 million.

Q. Your next entry has to do with Jin Sook Lee, properties returned, and to shareholder loan.

What generally does that have to do with it?

A. I'm sorry. Did you want an –

Q. Yeah. Just a brief explanation.

A. Well, that was their – it was, again, based upon the litigation, the lawsuit between Ms. Lee, HIE and Mr. Boulware.

And in the final analysis, after judgment was rendered, she returned and delivered to the trustee in bankruptcy that amount of money.

But because she was charged shareholder loans earlier – that shows up on Page 1 as $1 million – the deliveries by her of $3.3 million was reduced by the $1 million, the net difference was given credit, if you

will, as returns to HIE of HIE's properties that are here in dispute.

Q. And the reason that dollar amount is there is because of the judgment in the civil action; is that correct?

A. Yes, sir.

Q. So your total amount returned is $6,827,000?

A. Yes.

Q. And your next – your final entry says, excess amount returned. What does that mean?

A. That means that, in referring again to the earlier number [247] of $4,872,000, I said that the $4 million – that amount was in dispute. Meaning the government, $10.2 million; the taxpayer, that lower amount of $4.8 million.

But if the taxpayer owed that amount to HIE, whether it's corporate advances or potential taxable income, his delivery of these properties back to the corporation, certainly if they are advances, he's returned, fully repaid those advances; and therefore, he's fully satisfied his obligation, and there are no tax consequences there.

If there are potentially taxable amounts, then he has returned these amounts back to HIE; again, and he should therefore not be taxed.

MR. O'CONNOR: This might be a good time to break.

THE COURT: We will adjourn at this time, and reconvene at 9:00 tomorrow morning.

Hopefully – you have one more witness after this?

MR. O'CONNOR: That's correct, Your Honor.

THE COURT: Who is that?

MR. O'CONNOR: Mr. Hunsaker, our expert witness.

THE CLERK: All rise for the jurors.

(The jury was excused at 4:40 p.m.)

(The hearing in the above-entitled cause was concluded at 4:41 p.m.)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	)	CRIMINAL NO. 99-00239ER - VOLUME 10 -

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Wednesday, July 13, 2005, at 9:05 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNER, ESQ.
DENNIS E.W. O'CONNER, JR., ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[3] (The following proceedings were held in open court, outside the presence of the jury:)

THE COURT: Let the record show the court is meeting with counsel without the presence of the jury.

I just convened this to make certain that we don't have any problems.

I want to know what your next expert – what the subject of that witness' testimony is.

MR. O'CONNOR: He will testify as an expert accountant, Your Honor, regarding the accounting of the company, and will testify regarding Mr. Boulware's income, basically.

THE COURT: Well, does it relate to either that the transfers made to your client could have been dividends or return of capital?

MR. O'CONNOR: No, it does not relate to that.

THE COURT: All right.

MR. O'CONNOR: It relates to basic accounting.

THE COURT: Just basic accounting?

MR. O'CONNOR: Yes.

THE COURT: That's good. And that's what I wanted to make sure of.

MR. O'CONNOR: Yes.

* * *

[132] One's clean, and one has the cite.

The line in italics would be the added line.

THE COURT: Are you sure? This appears to be identical to ours.

MR. DWYER: It's just one line, Your Honor.

THE COURT: Where is this line? In italics?

MR. DWYER: Yes, Your Honor.

THE COURT: (Perusing document.)

I don't like the line because of the language it uses. And it would be over the heads of the jurors. And I think we're better off without it.

MR. DWYER: Very well, Your Honor.

THE COURT: You can argue that if you want.

MR. DWYER: Otherwise, Your Honor, the government has no objections.

THE COURT: All right.

How about the defendant?

MR. O'CONNOR, JR.: Your Honor, we do object to several of the proposed –

THE COURT: Well, you have written objections to numbers 11, 13 and 15, which the court has considered and modified.

MR. O'CONNOR, JR.: I understand that.

Those objections were submitted by Mr. Kaneshiro, Your Honor. So I am here arguing today –

* * *

[138] THE COURT: Well, this is not good faith. This is the reliance on the advice of counsel instruction.

You don't want that given?

(Discussion off the record between counsel.)

MR. O'CONNOR, JR.: We're on 11, Your Honor.

THE COURT: I'm on 11.

MR. O'CONNOR, JR.: Okay.

THE COURT: If you read it, it says that –

MR. O'CONNOR, JR.: Well, it starts –

THE COURT: It relates good faith in terms of relying on counsel's advice.

MR. O'CONNOR, JR.: It mixes the two, Your Honor. And we submitted a good faith instruction that didn't mix the two. We also submitted a reliance on counsel instruction.

THE COURT: All right, the objection is overruled.

MR. O'CONNOR, JR.: Thank you –

THE COURT: Do you wish to have the court give a reliance on the advice of counsel instruction? I'll withdraw it if you don't.

MR. O'CONNOR, JR.: Yes, Your Honor, we do.

THE COURT: All right.

Any other instruction?

MR. O'CONNOR, JR.: Instruction 13, Your Honor.

THE COURT: 13. This is the definition of income, [139] gross income for income tax purposes?

MR. O'CONNOR, JR.: Yes, Your Honor.

And this does follow the James case.

It's just that we had other language that we proposed concerning the definition –

THE COURT: We changed this to – we found that you were correct, that when monies are – and we changed the language to be consistent with James versus United States, which is a Supreme Court case from which this language came.

MR. O'CONNOR, JR.: I understand, Your Honor.

We are not objecting to that change. What we are saying is that there was further definition in our proposed instruction that we believe –

THE COURT: Let me see the proposed instruction.

(Perusing documents.)

I will not give this instruction.

One, it's much too lengthy.

Two, it represents an argument. It is an argumentative instruction, not a simple, neutral statement of the law. Which is what I strive for.

Therefore, I will give the one we have selected, unless you think that you will wish to argue that it is incorrect in some way.

MR. O'CONNOR, JR.: No, Your Honor, i am not arguing that the statement of the law is incorrect.

[140] I'm arguing that it's incomplete, and that ours is a more complete version. That's all, Your Honor.

THE COURT: I think this is a more neutral statement of the law.

You can argue whatever you wish, you know, about income, so long as it's consistent with that instruction.

MR. O'CONNOR, JR.: Thank you, Your Honor.

THE COURT: The next item is that the loan is not income.

Is that one you object to, 14?

MR. O'CONNOR, JR.: Well, the objection, Your Honor, was –

THE COURT: Do you object to 14?

MR. O'CONNOR, JR.: Yes, Your Honor.

THE COURT: All right. What is the objection?

MR. O'CONNOR, JR.: The objection is that the factors that are put forth in this instruction are not exclusive.

THE COURT: They're not what?

MR. O'CONNOR, JR.: We believe that there should be language in this instruction that these factors are not exclusive . . .

(Discussion off the record between counsel.)

MR. O'CONNOR, JR.: No objection, Your Honor.

THE COURT: That language is in there, is it not?

[141] MR. O'CONNOR, JR.: I see it. I didn't see it earlier. I apologize, Your Honor.

THE COURT: Any others?

MR. O'CONNOR, JR.: Instruction 15, Your Honor.

THE COURT: Now, this is the one you filed written objections to.

And this basically adopts the language largely from the case of United States versus Hall. Which is a Ninth Circuit case.

You objected to the proposed instruction on the ground that it did not discuss the requirement that the government find the defendant's initial cash on hand.

Ordinarily, that is required. Because the deposits may include cash earned in prior years.

However, Agent Yamachika testified he did not include any cash deposits in his analysis.

Thus, there is no risk that the government's analysis includes cash deposits of funds legitimately earned in prior years.

And in addition, the Ninth Circuit has held that the government need not establish initial cash on hand where cash deposits were not considered. This was in an unpublished case, but they have done that.

So we have included language to the effect in the instruction itself. Although –

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA,	)	CRIMINAL NO. 99-00239ER
Plaintiff,	)	
vs.	)	– VOLUME 11 –
MICHAEL H. BOULWARE,	)	
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

The above-entitled matter came on for hearing on Thursday, July 14, 2005, at 9:05 a.m., at Honolulu, Hawaii

BEFORE: THE HONORABLE
EDWARD RAFEEDIE
United States District Judge

REPORTED BY: STEPHEN B. PLATT, RMR, CRR
Official U.S. District Court Reporter

APPEARANCES: LESLIE E. OSBORNE, JR., ESQ.
U.S. Attorney's Office
300 Ala Moana Blvd., Suite 6100
Honolulu, Hawaii 96813

JARED E. DWYER, ESQ.
U.S. Department of Justice
Tax Division, P.O. Box 972
Washington, D.C. 20044

Attorneys for the Government

DENNIS E.W. O'CONNOR, ESQ.
DENNIS E.W. O'CONNOR, JR., ESQ.
Reinwald O'Connor & Playdon
733 Bishop Street, 24th floor
Honolulu, Hawaii 96813

Attorneys for the Defendant

* * *

[23] whom the defendant considered competent, made a full and accurate report to that attorney of all material facts of which the defendant had the means of knowledge, and then acted strictly in accordance with the advice given by that attorney.

Whether the defendant acted in good faith for the purpose of seeking advice concerning questions about which the defendant was in doubt, and whether the defendant made a full and complete report to the attorney, and whether the defendant acted strictly in accordance with the advice received are all questions for you to determine.

Now, it's the defendant's position that the money and property that the government claims as taxable income to him were corporate assets of Hawaiian Isle Enterprises and its affiliates.

Since the money and property were corporate assets, the defendant contends they were not reportable income to him during the years in question.

It is the defendant's position that he did not knowingly and willfully attempt to evade or defeat

substantial income tax, and did not knowingly and willfully file false tax returns.

Of course, the plea of not guilty creates those issues, as well.

Mr. Boulware believed that the monies and property were accounted for as assets and/or property of the company, [24] or as officer loans.

The term "gross income" for income tax purposes consists of income from whatever source derived, including but not limited to compensation for services.

The term "taxable income" means gross income, minus any deductions allowed by law.

When monies are acquired, either lawfully or unlawfully, without consensual recognition of an obligation to repay, and without restriction on their disposition, such monies are income, even though it may still be claimed that the defendant is not entitled to retain the money, and even though he may be required to restore its equivalent.

A loan is not income.

A loan is an agreement, either express or implied, whereby one party advances money to the other, and the other agrees to repay it upon such terms as to time and rate of interest, or without interest, as the parties may agree.

Essentially, you must determine whether the parties actually intended for the funds to be repaid at the time that they were transferred.

In making this determination, the following factors may be relevant, although they are not exclusive, and no single factor is dispositive:

One, whether the promise to repay is evidenced by a note or other instrument.

* * *

United States District Court
District of Hawaii

UNITED STATES OF AMERICA	**JUDGMENT IN A CRIMINAL CASE**
v.	(Filed Oct. 27, 2005)
MICHAEL H. BOULWARE	(For Offenses Committed On or After November 1, 1987)
	Case Number: **1:99CR00239-001**
	USM Number: **87201-022**
	Dennis O'Connor, Esq. Defendant's Attorney

THE DEFENDANT:

[ ] pleaded guilty to count(s): _____.

[ ] pleaded nolo contendere to count(s) _____ which was accepted by the court.

[✓] was found guilty on count(s) 1, 2, 3, 4, 5, 6, 7, 8, 9, 10 of the Second Superseding Indictment after a plea of not guilty.

The defendant is adjudicated guilty of these offenses:

Title & Section	Nature of Offense	Offense Ended	Count

See next page.

The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

[ ] The defendant has been found not guilty on count(s) _____ and is discharged as to such count(s).

[ ] Count(s) _____ (is)(are) dismissed on the motion of the United States.

It is further ordered that the defendant must notify the United States Attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid. If ordered to pay restitution, the defendant must notify the court and United States attorney of material changes in economic circumstances.

October 24, 2005
Date of Imposition of Judgment

/s/ Edward Rafeedie
Signature of Judicial Officer

EDWARD RAFEEDIE,
United States District Judge
Name & Title of Judicial Officer

OCT 26 2005
Date

ADDITIONAL COUNTS OF CONVICTION

Title & Section	Nature of Offense	Offense Ended	Count
26 U.S.C. §7206(1)	False tax return	06/08/1993	1

26 U.S.C. §7206(1)	False tax return	06/08/1993	2
26 U.S.C. §7206(1)	False tax return	06/08/1993	3
26 U.S.C. §7206(1)	False tax return	06/08/1993	4
26 U.S.C. §7206(1)	False tax return	08/15/1994	5
26 U.S.C. §7201	Tax evasion	10/15/1995	6
26 U.S.C. §7201	Tax evasion	09/30/1996	7
26 U.S.C. §7201	Tax evasion	08/07/1997	8
26 U.S.C. §7201	Tax evasion	10/14/1998	9
18 U.S.C. §371	Conspiracy to make false statement to influence a financial institution		10

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a total term of 60 MONTHS

This term consists of THIRTY SIX (36) MONTHS as to each of Counts 1, 2, 3, 4, 5 of the Second Superseding Indictment; SIXTY (60) MONTHS as to each of Counts 6, 7, 8, 9, 10 of the Second Superseding Indictment,

with all terms and counts to be served concurrently with each other.

[ ] The court makes the following recommendations to the Bureau of Prisons:

[ ] The defendant is remanded to the custody of the United States Marshal.

[ ] The defendant shall surrender to the United States Marshal for this district.

[ ] at _____ on _____ .

[ ] as notified by the United States Marshal.

[✓] The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons:

[✓] before 2:00 p.m. on 1/5/2006 .

[ ] as notified by the United States Marshal.

[ ] as notified by the Probation or Pretrial Services Office.

RETURN

I have executed this judgment as follows:

_____

_____

_____

Defendant delivered on _____ to _____ at _____ , with a certified copy of this judgment.

UNITED STATES MARSHAL

By _____
Deputy U.S. Marshal

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of 3 YEARS.

This term consists of ONE (1) YEAR as to each of Counts 1, 2, 3, 4, 5 of the Second Superseding Indictment; THREE (3) YEARS as to each of Counts 6, 7, 8, 9, 10 of the Second Superseding Indictment, with all terms and counts to be served concurrently with each other.

The defendant must report to the probation office in the district to which the defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

The defendant shall not commit another federal, state, or local crime.

The defendant shall not unlawfully possess a controlled substance. The defendant shall refrain from any unlawful use of a controlled substance. The defendant shall submit to one drug test within 15 days of commencement of supervision and at least two periodic drug tests thereafter but no more than 8 valid drug tests per month during the term of supervision.

[✓] The above drug testing condition is suspended, based on the court's determination that the defendant poses a low risk of future substance abuse. (Check, if applicable.)

[✓] The defendant shall not possess a firearm, ammunition, destructive device, or any other dangerous weapon. (Check, if applicable.)

[✓] The defendant shall cooperate in the collection of DNA as directed by the probation officer. (Check, if applicable.)

[ ] The defendant shall register with the state sex offender registration agency in the state where the defendant resides, works, or is a student, as directed by the probation officer. (Check, if applicable.)

[ ] The defendant shall participate in an approved program for domestic violence. (Check, if applicable.)

If this judgment imposes a fine or restitution, it is a condition of supervised release that the defendant pay in accordance with the Schedule of Payments sheet of this judgment.

The defendant must comply with the standard conditions that have been adopted by this court as well as with any additional conditions on the attached page.

STANDARD CONDITIONS OF SUPERVISION

1) the defendant shall not leave the judicial district without the permission of the court or probation officer;

2) the defendant shall report to the probation officer and shall submit a truthful and complete written report within the first five days of each month;

3) the defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;

4) the defendant shall support his or her dependents and meet other family responsibilities;

5) the defendant shall work regularly at a lawful occupation, unless excused by the probation officer for schooling, training, or other acceptable reasons;

6) the defendant shall notify the probation officer ten days prior to any change in residence or employment;

7) the defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute, or administer any controlled substance or any paraphernalia related to any controlled substances, except as prescribed by a physician;

8) the defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;

9) the defendant shall not associate with any persons engaged in criminal activity and shall not associate with any person convicted of a felony,

unless granted permission to do so by the probation officer;

10) the defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view of the probation officer;

11) the defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;

12) the defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court;

13) as directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record or personal history or characteristics and shall permit the probation officer to make such notifications and to confirm the defendant's compliance with such notification requirement.

SPECIAL CONDITIONS OF SUPERVISION

1. That the defendant execute all financial disclosure forms, and provide the Probation Office and the Financial Litigation Unit of the U.S. Attorney's Office access to any requested financial information to include submitting to periodic debtor's examinations as directed by the Probation Office.

2. That the defendant cooperate with the Internal Revenue Service and arrange for the payment of

delinquent taxes, interest and penalties, and the timely filling of tax returns and/or corrected amended tax returns.

CRIMINAL MONETARY PENALTIES

The defendant must pay the total criminal monetary penalties under the schedule of payments on Sheet 6.

	Assessment	Fine	Restitution
Totals	$ 650.00	$ 25,000	$

[ ] The determination of restitution is deferred until ___. An *Amended Judgment in a Criminal Case* (AO245C) will be entered after such determination.

[ ] The defendant must make restitution (including community restitution) to the following payees in the amount listed below.

If the defendant makes a partial payment, each payee shall receive an approximately proportioned payment, unless specified otherwise in the priority order or percentage payment column below. However, pursuant to 18 U.S.C. §3664(i), all non-federal victims must be paid before the United States is paid.

Name of Payee	**Total Loss***	**Restitution Ordered**	**Priority or Percentage**
TOTALS	$ _____	$ _____	

[ ] Restitution amount ordered pursuant to plea agreement $ _____

[ ] The defendant must pay interest on restitution and a fine of more than $2500, unless the restitution or fine is paid in full before the fifteenth day after the date of judgment, pursuant to 18 U.S.C. § 3612(f). All of the payment options on Sheet 6 may be subject to penalties for delinquency and default, pursuant to 18 U.S.C. § 3612(g).

[ ] The court determined that the defendant does not have the ability to pay interest, and it is ordered that:

[ ] the interest requirement is waived for the [ ] fine [ ] restitution

[ ] the interest requirement for the [ ] fine [ ] restitution is modified as follows:

Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

SCHEDULE OF PAYMENTS

Having assessed the defendant's ability to pay, payment of the total criminal monetary penalties are due as follows:

A [ ] Lump sum payment of $ _____ due immediately, balance due

[ ] not later than _____, or

[ ] in accordance [ ] C, [ ] D, [ ] E, or [ ] F below; or

B [✓] Payment to begin immediately (may be combined with [ ] C, [ ] D, or [ ] F below); or

C [ ] Payment in equal _____ (e.g., weekly, monthly, quarterly) installments of $ _____ over a period of _____ (e.g., months or years), to commence _ _____ (e.g., 30 or 60 days) after the date of this judgment; or

D [ ] Payment in equal _____ (e.g., weekly, monthly, quarterly) installments of $ _____ over a period of _____ (e.g., months or years), to commence _____ (e.g., 30 or 60 days) after the release from imprisonment to a term of supervision; or

E [ ] Payment during the term of supervised release will commence within _____ (e.g., 30 or 60 days) after release from imprisonment. The court will set the payment plan based on an assessment of the defendant's ability to pay at that time; or

F [ ] Special instructions regarding the payment of criminal monetary penalties:

Unless the court has expressly ordered otherwise, if this judgment imposes imprisonment, payment of criminal monetary penalties is due during imprisonment. All criminal monetary penalties, except those payments made through the Federal Bureau of Prisons' Inmate Financial Responsibility Program, are made to the Clerk of the Court.

The defendant shall receive credit for all payments previously made toward any criminal monetary penalties imposed.

[ ] Joint and Several

Defendant and Co-Defendant Names and Case Numbers (including defendant number, Total Amount, Joint and Several Amount, and corresponding pay, if appropriate.

[✓] The defendant shall pay the cost of prosecution. $10,056.14 for first trial and $8,718 for second trial, payable within 30 days of sentencing.

[ ] The defendant shall pay the following court cost(s):

[ ] The defendant shall forfeit the defendant's interest in the following property to the United States:

Payments shall be applied in the following order: (1) assessment, (2) restitution principal, (3) restitution interest, (4) fine principal, (5) fine interest, (6) community restitution, (7) penalties, and (8) costs, including cost of prosecution and court costs.

ROBERT J. WATERS 67952
Attorney at Law
2115 Main Street
Santa Monica, CA 90405
Tel: 310 399-3259; Fax: 310 392-9029

REINWALD O'CONNOR & PLAYDON LLP
A Limited Liability Law Partnership

DENNIS E. W. O'CONNOR 561-0
24th Floor, Makai Tower
733 Bishop Street
Honolulu, Hawaii 96813
Telephone: 808 524-8350

Attorneys for Defendant-Appellant
MICHAEL H. BOULWARE

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

UNITED STATES OF AMERICA, Plaintiff, vs. MICHAEL H. BOULWARE, Defendant.	CASE NO. 99-00239-ER NOTICE OF APPEAL; CERTIFICATE OF SERVICE (Filed Nov. 02, 2005)

NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that defendant Michael H. Boulware hereby appeals to the United States Court of Appeals for the Ninth Circuit from

the Conviction and Sentence on Counts 1 through 9 and from the Sentence on Count 10 pronounced in this action on October 24, 2005.

DATED: Honolulu, Hawaii, November 2, 2005.

/s/ [Illegible]
ROBERT J. WATERS
DENNIS E. W. O'CONNOR

Attorneys for Defendant-Appellant
MICHAEL H. BOULWARE